

Minnesota

Department of Finance

November 1998

Highlights

Strong Economy and Tobacco Settlement Boost Current Budget Balance to \$953 Million

General fund revenues in F.Y. 1998-99, including tobacco settlement payments, are now forecast at \$22.241 billion, up \$1.264 billion from February's forecast. Non-tobacco revenues grew by \$803 million (3.8 percent), while tobacco payments total \$461 million. Forecast expenditures are down \$262 million. Under current law the first \$609 million of any projected balance is automatically allocated, leaving an available balance for the current biennium of \$953 million.

Structural Balance of \$876 Million in F.Y. 2003

Further revenue growth, continued lower expenditures, and additional tobacco money raise the projected budget balance for 2000-01 by \$1.8 billion. But, permanent tax or spending changes must be approached cautiously. The structural balance for F.Y. 2001, the difference between forecast revenues and expenditures less the one-time portion of the tobacco payments, is only \$821 million. By F.Y. 2003 the structural balance grows to \$876 million. New, ongoing commitments in the 2000-01 budget should be limited to that amount to avoid creating future budget imbalances.

Individual Income Tax Forecast Up \$1.2 Billion through F.Y. 2001--Corporate Tax Forecast Down \$338 Million

Stronger than projected wage increases and record capital gains in tax year 1997 were responsible for much of the additional income tax revenue over the 4 year forecast horizon. Corporate income tax receipts in the next biennium are now forecast to be 7 percent less than in the current biennium, consistent with DRI's forecast for lower corporate profits through 2001.

Strong Economy Slows Growth in Human Services Spending

Forecast spending on health care drops by \$173 million in F.Y. 1998-99 and \$255 million in F.Y. 2000-01 from end-of-session estimates. However, spending in this and other major areas of Minnesota's budget continues to grow faster than general fund revenue.

November 1998 Economic Forecast

BUDGET SUMMARY

Strong Economy, Tobacco Settlement Add \$1.5 Billion for 1998-99, and \$1.8 Billion in 2000-01

Stronger than anticipated U.S. economic growth, record realizations of capital gains, and a general fund tobacco settlement windfall of \$461 million have combined to increase the revenue forecast for the current biennium by \$1.264 billion. In addition, state expenditures, net of a \$34 million increase in dedicated reserves, are now forecast to be \$262 million below end-of-session estimates. The combined impact of the tobacco settlement, higher than forecast revenues, and lower than projected expenditures adds \$1.526 billion to this biennium's expected ending balance.

The higher revenues and lower than forecast expenditures continue through the next biennium, adding a further \$1.074 billion to the projected balance for the 2000-01 biennium.

When the \$727 million in tobacco settlement payments scheduled in the next biennium is added, the projected balance for the next biennium grows by an additional \$1.801 billion.

Tobacco Settlement Accounts for More Than One-Third of Forecast Gain (\$ in millions)

| <u>F.Y. 1998-99</u> | <u>F.Y. 2000-01</u> |
|----------------------|----------------------|
| \$1,526 | \$1,801 |
| Tobacco - \$461 | Tobacco - \$727 |
| Expenditures - \$262 | Expenditures - \$421 |
| Revenues - \$803 | Revenues - \$653 |

After Statutory Allocations, 1998-99 Surplus Is \$953 Million

The 1998 Legislature set aside the first \$609 million of any surplus forecast for this biennium. Under current law \$9 million of that balance will go to the budget reserve, \$200 million will be placed in a special tax reduction account, and \$400 million will be used to replace bonding for capital budget projects authorized in 1998. Those allocations reduce the available balance for the current biennium to \$953 million. Caution should be used in allocating those funds to avoid creating on-going obligations that exceed future revenues.

1998-99 General Fund
(\$ in millions)

| | |
|---|-----------------------|
| Beginning Balance | \$1,995 |
| Revenues | 20,855 |
| Tobacco Settlement | 461 |
| Transfers, Other | 925 |
| Expenditures | 21,249 |
| Cash Flow Account | 350 |
| Budget Reserve | 613 |
| Dedicated Reserves | <u>462</u> |
| <i>Forecast Balance Before Allocations</i> | <i>\$1,562</i> |
| <i>Less Statutory Allocation</i> | |
| ■ Budget Reserve to \$622 | 9 |
| ■ New Tax Reduction Account | 200 |
| ■ Cash to Replace Bonding | <u>400</u> |
| <i>Balance After Allocations</i> | <i>\$953</i> |

Structural Balance of \$876 Million in FY 2003

Decisions on permanent tax and spending changes for the 2000-01 biennium should be made with care. Prudent financial management would limit on-going tax and spending changes to an amount sustainable in the future. If that is not done, a tax increase or spending cuts will be necessary to balance the budget in 2002-03. The structural balance in the last year of the next biennium, the difference between forecast revenues and expenditures less the one time portion of the tobacco settlement, is \$821 million. Limiting the amounts of permanent tax and spending changes to a total of about \$876 million per year in FY 2003 will keep Minnesota's budget in structural balance.

Structural Balance FY 2000-03

(\$ in millions)

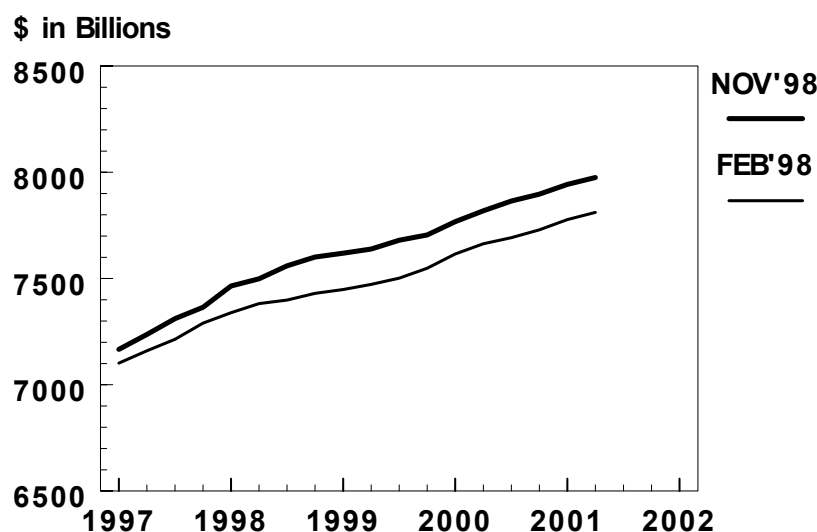
| | <u>FY 2000</u> | <u>FY 2001</u> | <u>FY 2002</u> | <u>FY 2003</u> |
|-----------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Revenues | 12,059 | 12,579 | 13,092 | 13,526 |
| Less: One-Time Tobacco Revenue | (242) | (242) | (243) | (121) |
| Expenditures | <u>11,080</u> | <u>11,516</u> | <u>11,979</u> | <u>12,529</u> |
| <i>Structural Balance</i> | <i>\$737</i> | <i>\$821</i> | <i>\$870</i> | <i>\$876</i> |

Economy Stronger than Forecast in 1998. Good Growth Forecast for 1999, 2000, and 2001.

U.S. economic growth this year has exceeded earlier expectations. Asia's serious and continuing economic problems have affected agriculture and a few key manufacturing sectors, but to this point increased consumer spending has more than offset the impact of weaker export markets. The U. S. economy appears well on its way to a third consecutive year in which real GDP growth rates exceed 3.4 percent, the best 3-year growth record since the recovery following the 1982 recession.

Data Resources Inc. (DRI), Minnesota's national economic consultant has raised their outlook for economic growth in 1998 and 1999. At the time of the last revenue forecast they, along with most other forecasters, were projecting real GDP growth of 2.7 percent for 1998. Now, their Control forecast calls for 3.6 percent real GDP growth in 1998. That growth rate exceeds expectations of even the most optimistic of forecasters in early 1998. At present, both DRI and the Blue Chip Consensus expect a significant slowdown in 1999. DRI forecasts real GDP to grow at a 1.7 percent rate in 1999; the Blue Chip consensus is for 2.1 percent growth.

Stronger Economy Lifts Economic Forecast (Real GDP - \$92)



There is no recession in the November Control, but DRI cautions that the probability of a recession during the next two years is nearing 50 percent. They note, "Over the past three months the economic and financial crisis that began in Asia during the summer of 1997 has taken a sudden and dramatic turn for the worse." A special study assessing the risks of global recession which accompanies the November Control concludes by noting "the likelihood of a worst case scenario--and a world recession--remains too high for comfort".

The Finance Department, at the Governor's request, conducted a special study to identify the impact of a U.S. recession on Minnesota's finances. That study found a recession could cost the state \$1.5 billion over the next biennium. The average economic expansion lasts only four years, and we are now in the eighth year of the current expansion. If the U.S. economy avoids a recession through the end of 2002, the current expansion would have extended nearly three years beyond the previous record.

Income Tax Forecast up Due to Higher Wages and Large Increase in Capital Gains

FY 1998-99 receipts from the four major taxes are now forecast to total \$18.748 billion, \$561 million (3.1 percent), more than end-of-session estimates. Forecast revenues from the four major taxes for the 2000-01 biennium exceed prior planning estimates by \$649 million or 3.2 percent. Individual income tax revenues are now forecast to exceed end-of-session estimates by \$519 million in the current biennium. For 2000-01 the current income tax forecast exceeds previous planning estimates by \$686 million. The forecast for current biennium corporate income tax receipts was cut by \$94 million; that for the next biennium by \$244 million.

Revenue Outlook Improves for FY 1998-99 and FY 2000-01
Change in Forecast -- \$ in Millions

| | <u>FY 1998-99</u> | <u>FY 2000-01</u> |
|---------------------|-------------------|-------------------|
| Income | 519 | 686 |
| Sales | 72 | 149 |
| Corporate | (94) | (244) |
| Motor Vehicle | <u>64</u> | <u>58</u> |
| Major Taxes | 561 | 649 |
| Other (non-tobacco) | <u>242</u> | <u>4</u> |
| Total Change | 803 | 653 |

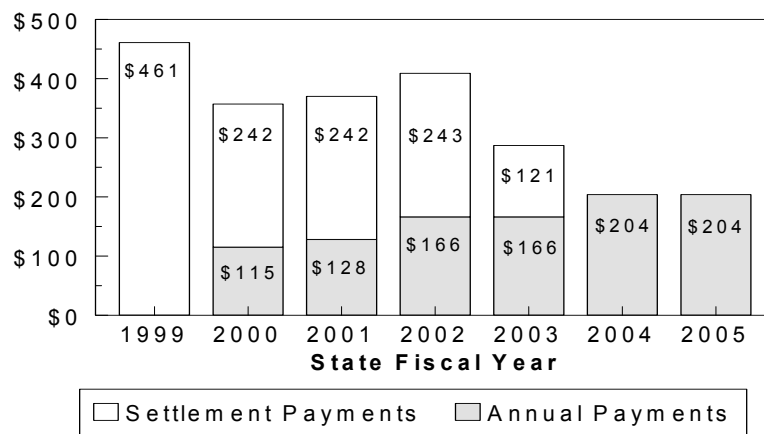
Much of the additional income tax revenue came from carrying forward higher base level revenues observed for tax year 1997. Revised wage data shows Minnesota wages growing more rapidly than previously believed, and early data from tax year 1997 income tax filings indicate that capital gains realizations grew to record levels. Both those changes raised the starting point for the forecasts for future tax years. The higher tax base carried forward from tax year 1997 explains the majority of the increase in expected income tax revenue through the entire forecast horizon.

The drop in corporate income tax receipts is largely attributable to a reduction in the forecast for pre-tax corporate profits. Recent court decisions increased the corporate refund forecast by \$20 million in the current biennium, and \$20 million in FY 2000-01.

Tobacco Settlement Adds Both One-time and Permanent Revenues

The state's tobacco settlement agreement is composed of two separate streams of funds: *settlement* payments, which end in FY 2003, and *annual* payments, which continue in perpetuity.

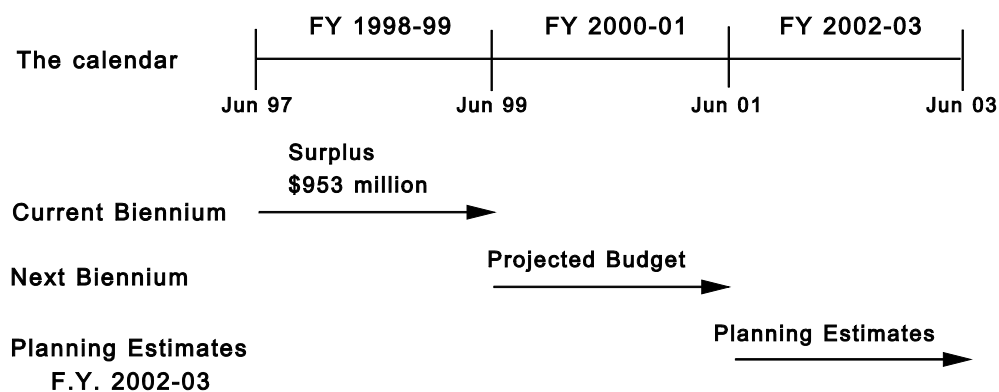
Minnesota General Fund Tobacco Settlement Revenues
FY 1999-2005
(\$ in millions)



The *settlement* payments total \$1.3 billion through 2003, when they will end. The *annual* payments grow from \$115 million in fiscal year 2000 to \$204 million in fiscal year 2004 and continue at that level in perpetuity. Policy makers should be mindful of the one-time nature of the *settlement* payments when making budget decisions.

Net Savings of \$262 Million in Spending and Other Changes in Current Biennium; \$421 Million in FY 2000-01

Spending for the current biennium has fallen by \$296 million, 1.4 percent from end-of-session estimates. These savings are offset by a \$34 million increase in dedicated reserves. While spending estimates are lower than previously forecast, spending for human services, K-12 education, and property tax aids and credits continues to grow faster than state revenues.



Forecast Expenditure Changes

(\$ in millions)

| | <u>FY 1998-99</u> | <u>FY 2000-01</u> |
|------------------------------|-------------------|-------------------|
| Health Care | \$(173) | \$(255) |
| Family Support | (20) | (46) |
| K-12 Education | (39) | (80) |
| Tax Aids, Credits | (24) | (64) |
| All Other | <u>(40)</u> | <u>(42)</u> |
| Expenditures | \$(296) | \$(487) |
| Change in Dedicated Reserves | <u>34</u> | <u>66</u> |
| Net Change | \$(262) | \$(421) |

Savings in human services health care and family support programs account for nearly two-thirds (\$193 million) of the forecast expenditure savings in the current budget period. Lower health and income maintenance costs reflect the continued lower caseload growth accompanying the strong economy.

All other spending areas show modest reductions from previous estimates. Most notable are the K-12 education savings which reflect slightly lower enrollment data, and property tax refunds which reflect both fewer filers and smaller refunds.

Budget Time Line Defines Surpluses and Risks

The projections contained in the November forecast cover parts of six years and three state biennial budget periods. It is important that state policy makers understand the nature of forecast balances, the time periods covered by the forecast, and significant risks in forecasting thirty-one and fifty-five months into the future.

Current biennium:

The *projected* surplus is \$953 million, including tobacco settlements, and after statutory allocations.

By January, about \$1 billion of the \$1.5 billion forecast increase will be “in the bank.” The remainder will be received between then and June 30, 1999. Since there are seven months remaining in the current biennium, it is certain that the final surplus will be either higher or lower than forecast.

Future Budgets:

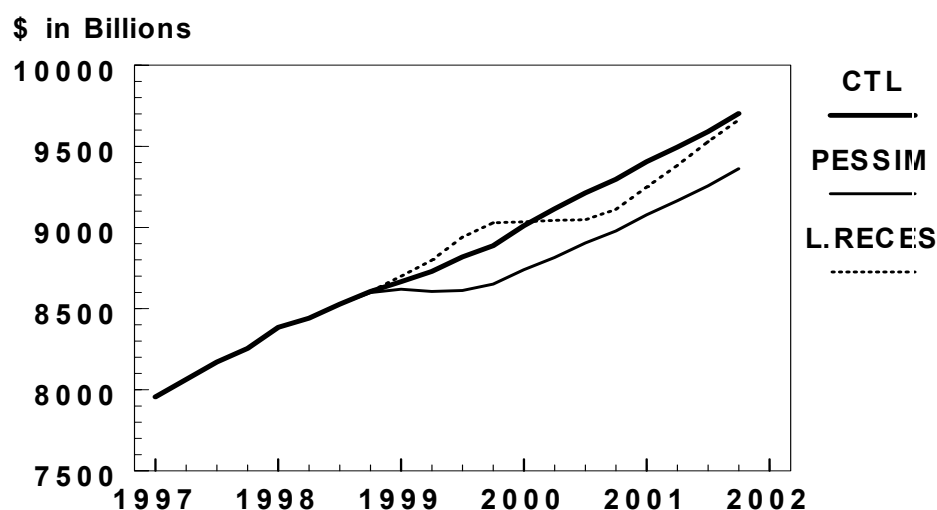
The revenue estimates for FY 2000-01 are the first actual forecast of state revenues for the coming biennium. Prior revenue figures were only simple extrapolations based on long term trends. The FY 2000-01 expenditure estimates are simply updated planning estimates of state spending. The planning estimates reflect only current authorized spending, adjusted for enrollment and caseload, and include an estimate of expected inflation during the period.

Forecast revenue and estimated expenditures provide the starting point for the development of the 2000-01 biennial budget. There is no approved budget in place. The Governor and state legislators should recognize potential forecast volatility in determining appropriate tax and spending initiatives, as well as in assessing the need to set aside adequate reserves for the next biennium.

ECONOMIC SUMMARY

Once again the U.S. economy has out-performed everyone's forecast. Ten months ago, no one expected a recession, but many worried that by mid-year a weakened trade sector would dramatically slow U.S. growth. Those fears appear to have been premature. The extent of the slump in Asia has been deeper than most anticipated, but the U.S. economy, to this point, remains strong. Consumer spending, which is nearly two-thirds of GDP, grew at an annual rate of more than 6 percent during the first half of 1998, well beyond what most thought likely. That early 1998 spending increase more than offset the impact of declining exports caused by a weaker global economy. By mid-year almost everyone's end-of-1997 outlook had been revealed to be too pessimistic, and most forecasters had raised their estimates of growth in 1998 significantly.

DRI Says Probability of Recession by End of 2000 is 45 Percent (Nominal GDP)



That does not, however, mean there is no risk of the U.S. economy faltering in 1999. Since June, the global economy has weakened further as economic difficulties spread from Asia to Russia and to Latin America. Russia's problems led to the devaluation of the ruble and a default on externally held debt, weakening balance sheets of major financial institutions throughout the world. When those institutions adjusted their portfolios to emphasize credit quality and liquidity, the demand for U.S. Treasury bonds increased, and demand for other bonds fell. The resulting increase in the gap between the interest rates on Treasury obligations and all other credits led to the failure of some highly leveraged hedge funds. Those failures, in turn, led financial institutions to take further action to reduce risk and to increase the liquidity of their portfolios. Concern over an impending credit crunch had climbed to such a level that the Federal Reserve found it necessary to cut interest rates twice in 16 days by mid October. The Fed then underscored its October actions with a third rate cut at their November meeting.

Now, fears again seem to be abating. The preliminary third quarter GDP estimate was up a healthy 3.9 percent and credit is apparently flowing again. More important, for the moment at least, the international economic situation appears to have stabilized. The worst case scenarios for Brazil and Latin America appear to have been avoided and there are even some faint indications that the outlook for Asian countries other than Japan and Indonesia, could begin to improve by mid 1999. Corporate profits will remain under pressure, U.S. exports are anticipated to continue to shrink, and imports will increase well into 1999, but as long as consumers do not cut back on their spending, the U.S. economy is expected to continue growing through 2000.

Last February Data Resources Inc. (DRI), Minnesota's national economic consultant, was among those most concerned about the global impacts of Asia's economic problems. While they have raised their outlook for both 1998 and 1999, their forecast of 1.7 percent real growth in 1999 continues to be slightly below the Blue Chip Consensus growth rate of 2.1 percent. DRI's Control forecast for 1998 remains slightly above the Blue Chip Consensus, just as it was in February. In the Control forecast the economy strengthens slightly in 2000 and 2001 with growth proceeding at 2.3 percent and 2.1 percent annual rates, respectively. DRI believes inflation will remain well under control with CPI growth reaching about 3 percent in 2001.

Finance Department economists observed that while the level of real, inflation adjusted, economic activity forecast in the November Control is noticeably higher than that forecast in February, nominal (current dollar) GDP levels change only slightly. Much of the real growth in 1998, for example, has been offset by slower than anticipated growth in inflation. Other things equal, those unexpectedly low inflation rates would reduce both revenues and expenditure needs in the 2000-01 biennium.

Members of Minnesota's Council of Economic Advisors believe that the U.S. economy is likely to extend its current economic expansion into 2001 and possibly beyond. However, the Council noted that the agricultural sector's current problems and Minnesota's tight labor markets could make it difficult for the state's economy to keep pace with the U.S. averages over the next two years. While some individual forecasts for 1999 were more optimistic than DRI's November Control, others were more pessimistic, and Council members generally agreed that the DRI outlook for the 1999-2001 forecast horizon adequately reflected current concerns about the economy.

Council members noted that continued growth in consumer spending is critical to the outlook, and that while there is no reason to expect consumers to suddenly stop spending, it is unrealistic not to expect savings rates to increase from current levels. Others noted that recent interest rate cuts will offer many homeowners the opportunity to refinance their mortgages, freeing up additional discretionary income for both consumption and savings.

Several members observed that shifts in consumer spending are often caused by changes in consumer psychology triggered by events which raise individuals' concerns about their personal financial security. While those events are virtually impossible to forecast everyone agreed that a dramatic drop in the stock market or the collapse of a major financial institution

could produce a cutback in consumer spending, even though this fall's market correction and the collapse of several highly leveraged hedge funds appeared to have little impact on consumer behavior. Council members saw uncertainty about the future path of consumer spending as the major source of risk in the forecast. Council members and Finance Department economists were agreed that the trade and capital goods sectors were unlikely to show substantial real growth in 1999.

DRI assigned the November Control a probability of 55 percent. Two more pessimistic scenarios, both containing a recession at some point in the 1999-2001 forecast horizon were also provided by DRI. Pessimistic, a scenario containing a recession beginning in early 1999 which extends for three quarters was assigned a probability of 30 percent. The Late Recession scenario, which includes a recession beginning midway through 2000, was assigned a probability of 15 percent. Council members and Finance Department economists believe that while the probability attached to the recession scenarios is sobering, it offers a reasonable measure of the risk associated with this forecast. The Council and the Finance Department agreed, however, that the 30 percent probability assigned to a recession beginning in early 1999 was unrealistic. Members believed that a recession, occurring later in 1999 or in early 2000 was more likely.

Finance Department economists observed that while higher than expected capital gains realizations appear to account for a significant portion of the positive variance in tax year 1997 settle-up payments and refunds, there is no guarantee that capital gains will continue to outpace the forecast. Nationally capital gains realizations are believed to have increased by more than 150 percent during the past three years, well above their historical growth rate. This year's market volatility will increase the uncertainty associated with the capital gains forecast since individual investors may choose to offset realized gains with losses from elsewhere in their portfolio, or they may choose not to realize gains in 1998 and let their gains accumulate. Capital gains are the most volatile of all the components of the individual income tax base since in some years taxable realizations fall below prior year levels.

Council members believe that any commitments to permanent changes in taxes and spending made on the basis of this forecast should be limited to amounts which are sustainable over the long term. The Council noted that the tobacco settlement will pose a particular challenge to those managing the state's finances. The tobacco payments will provide Minnesota's general fund with a sizeable windfall through the end of the 2003 fiscal year. That windfall, however, includes funds that should be considered temporary and be used for one time programs or temporary tax cuts. The Council observed that beginning in 2004 tobacco payments are scheduled to fall to \$204 million, an amount equal to about 70 percent of that to be received in 2003, and only 50 percent of that scheduled for 2002. To avoid building in budget problems for the 2004-05 biennium, no more than \$200 million per year of the tobacco settlement revenues should be devoted to permanent changes in taxes or spending in the 2000-01 and 2002-03 bienniums. The remaining tobacco revenues should be used to fund one-time spending initiatives or temporary tax rebates.

Looking beyond the tobacco settlement payments, the Council emphasized that little of the additional tax revenue in this forecast is already in the bank. The projected surplus reflects

revenues which will not be received for as many as 31 months into the future, and which are not guaranteed. Recent surpluses came from a national economy which grew faster than forecast, an extremely strong stock market, and a series of other fortuitous events. Council members, noting the higher than normal uncertainty surrounding the current economic outlook, cautioned against assuming that budget surpluses will continue in the future. The Council once again observed that Minnesota's current budget reserve of \$622 million would be quickly depleted in any recession and they reminded policy makers that the goal for the state's budget reserve should be 5 percent of the biennial budget, not 5 percent of current year spending.

ECONOMIC OUTLOOK

After a booming first quarter, the economy was slowing in late summer when an overvalued stock market tumbled amid worldwide financial panic. Fortunately, global financial turmoil has subsided and the stock market has recovered during the past several weeks. For that, observers credit aggressive Federal Reserve easing along with the announcement of a long awaited International Monetary Fund bailout which hopefully will suffice to stabilize financial markets in Brazil and the rest of Latin America. DRI believes these favorable developments make a 1999 recession a little less likely than it seemed several weeks ago.

DRI remains very concerned though, warning that there still is a 45 percent chance of recession by the end of 2000. Since last summer's financial market tumult, consumers have been less optimistic and spending has slowed modestly. Economists are worried about the impact of more bad news. They cite as likely sources renewed financial market turmoil, a collapse in Latin American export markets, or more layoffs as firms seek to reverse declining profits. In any of these events, further retrenchment in consumer confidence and spending is likely. That would be unfortunate, because forecasters are counting on consumers to sustain the economy as trade deficits mount. At present, this seems possible. Confidence indexes remain at a high level. And October's retail sales were strong, a sign that bodes well for the Christmas season. But unsettling news is coming from overseas where a worldwide economic slump threatens to spread to the U.S. through the ballooning trade deficit.

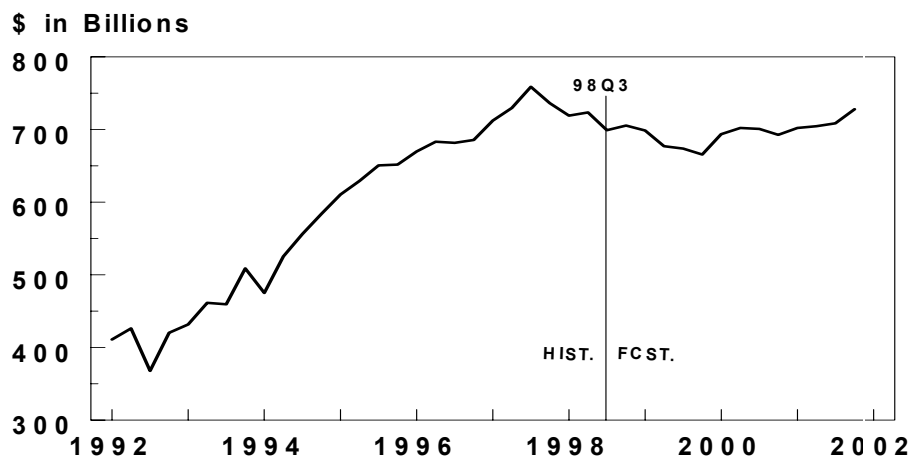
Practically all important U.S. trading partners face serious difficulties. Asia's recession will get worse if the devaluation of the Chinese renminbi that DRI expects next year sets off another round of capital flight from emerging market economies in a repeat of last summer's events. And Asia is no longer the only potential source of trouble. Latin America is also in a precarious state. Its largest economy, Brazil, is teetering on the brink of a recession many forecasters think is inevitable despite the bailout. The Western European and Canadian economies also look fragile to some observers. Because of significant U.S. exports to all these markets, Federal Reserve Chairman Greenspan summed up analysts' concerns several weeks ago when he said that it is implausible that deteriorating world financial and economic conditions will not have an adverse impact here.

The worldwide economic slump is having a significant impact on profits. Declining profits are economists' newest source of concern because the outlook has worsened considerably over the past few months. Overseas manufacturers are boosting efforts to sell goods in U.S. markets. As international competition heats up, profits are being squeezed since firms cannot get price increases needed to cover rising compensation costs. Many firms are seeking to control costs with layoffs which *Business Week* indicates are running about 60 percent ahead of last year.

Currently, the layoffs are not causing people to fear for a job. New jobs are still relatively easy to find, so the unemployment rate has increased only slightly since last winter. If jobs become harder to get and unemployment rises, or if something else happens to damage

confidence, weak auto sales or a bad Christmas retail season could be the first signs of trouble the Federal Reserve is trying to head off.

Corporate Profits



Profits are falling because competitive pressures are keeping firms from getting price increases as compensation costs rise faster than productivity. As a result, many firms are trying to control costs with layoffs which are running some 60 percent ahead of last year.

U.S. Is Not An Island

Last spring, the trade deficit began taking a big chunk out of real GDP growth. Exports are dropping because of declining demand as overseas recessions go on. Imports are rising in response to Asian currency devaluations. Practically all the negative impact has been confined to agriculture and the manufacturing sector, leaving the services sector intact. Consequently, most forecasters do not think the trade deficit will lead to a recession as long as consumer spending remains strong.

DRI believes there is significant risk consumer confidence and spending could be eroded by a repeat of last summer's sell off in the stock market and tumult in the bond markets. That risk will remain until it is clear the Brazilian bailout is working and Asia is on its way to solving its financial problems, issues which will take at least several months to resolve. Meanwhile, any future financial market instability will add to uncertainty in the minds of U.S. consumers, damaging confidence. Unfortunately, at the present time global economic and financial conditions are not reassuring.

World Economic Outlook Deteriorates

Among major world economies, only the U.S. is simultaneously experiencing low unemployment, low inflation, rising employment, and expanding real GDP. A few weeks ago an Associated Press article indicated that more countries are now in recession worldwide than at any one time in recent memory. The recessions in most East Asian countries have

few if any immediate prospects for ending while Japan flounders. Recessions are also underway in some countries of Africa, Latin America and Eastern Europe. Russia's perennial problems are getting worse.

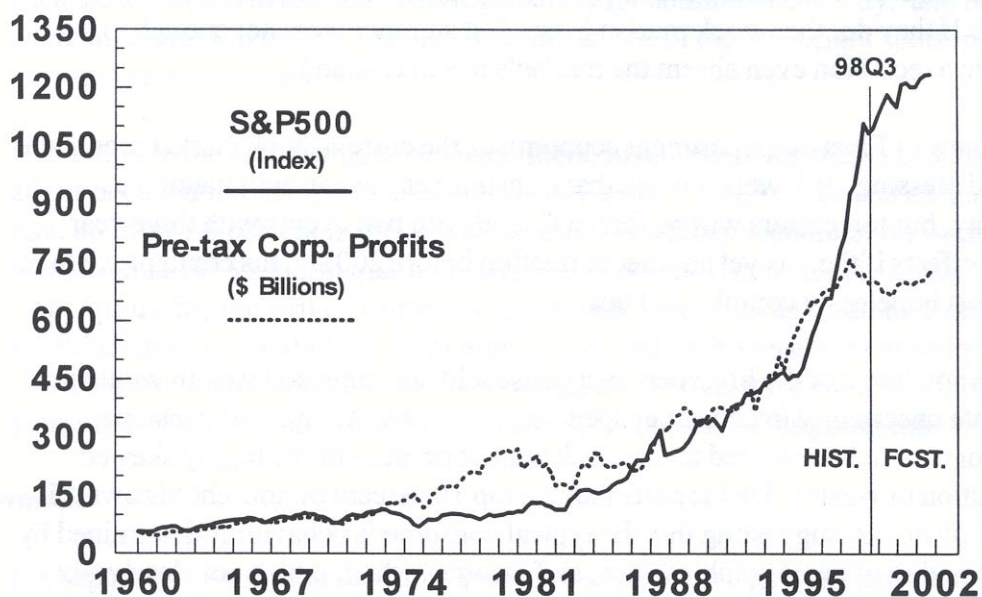
Canada, though not officially in recession, has experienced some softening for the last several months, the result of high interest rates needed to defend its dollar and because of slipping commodity exports to Asia. While Western Europe's economy continues to expand, some analysts believe that growth is threatened by a credit crunch as a result of last summer's heavy bank losses in emerging markets. Europe also faces slower growth as a result of any interest rate increases that monetary authorities may impose to establish the new euro as a reserve currency when it debuts January 1, 1999. All these soft spots in the world economy would be further weakened should there be a new wave of panic like the kind which engulfed financial markets last summer.

How Things Could Go Wrong

DRI's November Control scenario assumes the Chinese renminbi is devalued sometime next year. Among the expected consequences is another round of Asian devaluations and deepening recession there unless Japan somehow gets its economy moving again. But that is an event practically no economist will bet on because Japan's recently announced stimulus package and banking reform seem inadequate and possibly harmful according to an article in *The Economist*. DRI believes that when further difficulties develop, additional Asian money as well as other capital is likely to flee to safety in the U.S., causing a new round of worldwide financial instability which could easily escalate into a repeat of last summer's alarming problems. Investors in the U.S. and elsewhere remain very concerned about the future as indicated by relatively wide interest rate spreads between corporate and Treasury bonds. It appears to economists as though it would take very little to set off a new flight to safety and liquidity.

DRI's Asian scenario may somehow unfold without causing tumult in financial markets, but that would not necessarily leave the U.S. unscathed. Many Latin American currencies will come under additional downward pressure since these countries depend heavily on commodity sales to Asia. A recession which by then is likely to be underway in Brazil, as well as an already existing one in Venezuela, would deepen. In addition, growth is likely to slow in Mexico where the peso is weakening and interest rates are about 50 percent. Exports to Latin America would almost certainly decline as a result, making the U.S. economy more likely to slip into recession unless consumer spending takes up the slack.

Corporate Profits and the Stock Market



DRI's November forecast is for the stock market to continue its rebound. Last summer's correction did nothing to restore the close relationship between profits and stock prices which has persisted for decades.

Consumption

While stock market indexes have rebounded, consumer confidence remains below levels reached earlier this year. DRI and other forecasters relaxed a bit when confidence moved a little higher in November, but still believe another stock market correction would raise the risk that households will cut back spending. However, forecasting is difficult because economists have little understanding of how financial market fluctuations and spending are linked. In the current situation it is not clear how already wary consumers would react to further Wall Street problems with overseas roots.

Even if consumer psychology were better understood, Finance Department economists believe that large increases in stock market wealth accumulated in the past several years have raised the uncertainty attached to forecasting. One complicating factor is unrealized capital gains. For households having equities, there is very little hard data showing how they specifically respond to changes in wealth. The best economists can do are crude estimates for the entire economy which indicate an extra dollar of assets leads to about three or four cents of additional annual consumption spending, with about three years needed to realize the full effect. Gains in the stock market over the past three years therefore translate into about \$100 billion in spending at an annual rate in each quarter. But, another critical problem, as economists at American Express Financial Advisors see it, is whether consumers will respond in exactly the same way to a decline in equity wealth. If they do, then stock market losses last summer were not enough to generate a recession even absent the market's recent rebound.

In the view of Finance Department economists, the current stock market rebound is a mixed blessing. It lowers the risk that last summer's events will haunt the economy, but forecasters will be forced to deal with two events with three year lagged effects if there is yet another correction before 2001. This could prove to be an almost hopelessly complicated task.

Better knowledge of the links between household spending and wealth would not eliminate uncertainty in consumer spending forecasts. Analysis of consumer behavior cannot be confined to the stock market because of the highly skewed distribution of wealth. DRI reports that the top 10 percent of households own 85 percent of stocks, suggesting that the typical consumer's behavior is determined by a combination of demographics, jobs, and incomes which is also not clearly understood. For this reason, some economists are becoming increasingly concerned about layoffs.

DRI acknowledges the uncertainty, but has several reasons for expecting that consumer spending will sustain the economy. While below its peak, confidence is at a high level, spending remains strong, household net worth as a share of disposable income is at a record, wages are rising as employment growth keeps labor markets tight, low inflation means the purchasing power of wage gains is being preserved, and the latest wave of mortgage refinancing is freeing up cash flow for discretionary purchases.

Investment

Good consumer fundamentals and demand for second homes kept the housing market strong all summer. Analysts believe starts reached their peak in July, the highest level in 11 years according to DRI. For the foreseeable future, both starts and existing home sales are generally expected to soften, though remaining relatively high because of low interest rates. In its November Control forecast, DRI expects housing starts to remain above estimated demographic demand of 1.35 million units annually.

In early 1998, business spending for computers, aircraft, trucks, cars, and communications equipment boomed only to slow in the second half, partly because GM fleet sales shrank during the strike. Declining exports and weak profits also cut into sales of capital equipment to domestic manufacturers.

Recent experience is a sign of things to come. Declining profits, and rising excess production capacity lead DRI and other forecasters to expect business equipment spending growth will slow to single digits in 1999 and 2000, down from double digit levels in 1998. Investment in structures will also weaken considerably because the slump in exports is drying up need for additional capacity, and because the retail sector is overbuilt. Office building is one of the few bright spots in the business investment outlook.

According to the U.S. Commerce Department, inventory investment accounted for all the acceleration in third quarter, 1998 GDP growth to 3.3 percent at an annual rate, up from 1.8 percent in the second quarter. Inventory accumulation is expected to weaken in 1998's fourth quarter because GM is almost done replacing cars sold from lots during the strike.

Currently, there is no sign of accumulation of excess manufacturing or retail inventories often associated with a recession or sharp slowdown in the economy. Provided retailers do not overstock for Christmas, there seems to be little reason to expect an overhang of unsold goods going into 1999.

Government

On September 30, for the first time since 1969, the federal government closed the fiscal year with a surplus. The \$70 billion surplus includes the revenues and expenses of the Social Security Trust Fund which collected more than it spent. Without the Trust Fund, there would have been a deficit of about \$40 billion.

In mid-October, Congress passed and President Clinton signed a \$520 billion fiscal 1999 budget bill which ran to some 4000 pages. A recent *Wall Street Journal* article attempted to sum up the results. First, \$482 billion covers the cabinet departments and the foreign aid budget. Then there is \$17.9 billion for the International Monetary Fund as requested by the Clinton Administration. Finally, there are \$20.8 billion in off-budget, "emergency" expenditures which are primarily for Bosnia peacekeeping, embassy security, military readiness, and aid to farmers. By attaching the emergency designation, Congress was able to step around spending caps previously enacted.

Analysts are still examining the budget document for its impacts on future deficits or surpluses. DRI's November Control forecast assumes a \$63 billion surplus in fiscal 1999 based on recent projections by the Congressional Budget Office.

International

Asia's deep recession is the primary reason for the burgeoning U.S. trade deficit. Asia took its first really big bite from the U.S. economy in the second quarter when the trade gap sliced about 2.5 percentage points off real GDP growth according to DRI. This was a major factor in reducing growth from 5.5 percent at an annual rate in the first quarter to only 1.8 percent in the second, setting the economy on its present slower course. Both exports and imports contributed to the rising deficit. Practically all categories of exports declined with agricultural products and capital goods leading the way. At the same time, most imports rose rapidly. DRI expects the merchandise trade deficit to continue to rise through 2003.

In the view of Finance Department economists, so much attention seems focused on Asia and Latin America that potential problems in Western Europe are in danger of being overlooked. Outside the U.S., Europe is practically the sole remaining major economy capable of helping to sustain world growth. A European recession could cut into exports enough to have serious impacts on the U.S. outlook.

Fortunately, few analysts believe a European recession is likely anytime soon. However, there are some concerns. One is the European Economic and Monetary Union and its currency, the euro, scheduled to debut January 1, 1999. This single currency will eventually replace the separate national currencies, eliminating conversion costs and exchange rate risk

in business transactions. Most analysts expect the savings to be significant, but making the Union work could be difficult.

With a single currency, there can be only one central bank monetary policy which must encourage growth and reduce unemployment in all the diverse parts of Europe if the Union is to remain politically acceptable. That goal may not be compatible with the new central bank's stated objectives which are to control inflation and set interest rates high enough to make the euro attractive as a reserve currency capable of competing with the dollar. If the inflation and reserve currency objectives get priority, interest rates may be set too high to allow the economic growth needed to reduce high European unemployment which runs to double digits in Italy and France. Political instability and the Union's failure could then follow. Economists have only begun to think about the consequences should the euro experiment fail.

Other concerns center around European industry which *Business Week* indicates is ten years behind the U.S. in restructuring. Even before the world economy slumped, rates of return on capital were only about one-half those in the U.S. With poor returns, it is not clear Europe can attract the investment needed to generate growth rates comparable to those in the U.S. Unless that happens, European export markets may contribute less to U.S. GDP than they have in the past.

Monetary

By mid-November the Federal Reserve had cut short term interest rates three times for a total of 75 basis points in only seven weeks. The mid-October easing was unexpected because it is unusual, though not unprecedented, for the Fed to cut rates between meetings of its policy committee. Observers attribute the Fed's action to rising concern about a U.S. recession caused by a slowing world economy and instability in financial markets.

In early October, financial officials from dozens of countries convened at the annual meetings of the International Monetary Fund and the World Bank in Washington, D.C. Some observers expected that delegates would do as President Clinton urged and work out coordinated policy actions to stabilize world financial markets and to promote growth. Unfortunately, in the view of Merrill Lynch economists and many others, practically nothing was accomplished. A bailout package for Brazil was discussed, but had to be shelved for weeks when international banks refused to participate. More important for the long term, there was no agreement for coordinated, collective action to reduce volatility in international capital flows.

Just what should be done is the subject of much debate which so far has been fruitless. A recent summit conference of Pacific Rim countries held in Malaysia accomplished little. The vague and often acrimonious discussion suggests that governments are a long way from specific policy actions. Their dilemma seems profound. For political or cultural reasons, most Asian economies do not have the free markets they need to make efficient use of massive fund infusions available from abroad. Prime Minister Blair has been quoted in the press as saying that the world economy's problem is not that free market discipline has

failed, but that huge private capital flows in the absence of that discipline can have disastrous effects. In the view of many economists, solutions such as restrictions on capital flows or other regulation of securities markets, or a much stronger, more active International Monetary Fund, may violate free market principles, eventually either compounding the problem or leading to slower world economic growth.

Inflation

The consumer price index rose just 1.6 percent over the year ending in the third quarter 1998. While inflation was held in check by competition and falling commodity prices, compensation costs continued to rise, driven by higher wages as well as increased health care costs. A recent article in the *Wall Street Journal* reports the Bureau of Labor Statistics employment compensation index increased 3.7 percent over the last year. Wages and salaries were up 4.0 percent while benefits rose 2.6 percent. These observations are consistent with economists' expectations given the low unemployment rate.

Low inflation is translating into profitability problems for many companies. Compensation costs are rising faster than productivity. Companies have generally been unable to get offsetting price increases in highly competitive markets, so profits are being squeezed. As operating costs rose over the past several months, DRI revised its outlook for profits down sharply. Most observers believe firms will inevitably respond to profits pressure with further layoffs in an effort to control costs.

MINNESOTA OUTLOOK

With nine months preliminary data in hand, Minnesota's payroll employment is estimated to have increased 2.5 percent in 1998, up from 2.0 percent forecast last February. Using preliminary data from the first quarter, total wages are now forecast to rise 6.6 percent, up from February's 6.1 percent. For the U.S., DRI estimates 1998 employment will rise 2.5 percent, the same as in February. Total U.S. wages are expected to increase 6.6 percent in 1998, up from 6.3 percent previously forecast.

In 1999, Minnesota jobs are projected to rise 1.4 percent, compared to 1.0 percent. February's forecast of total wages are expected to increase 5.1 percent, up from 3.8 percent estimated earlier. In comparison, DRI expects U.S. employment to increase 1.3 percent, up from 0.9 percent in February. Total wages will rise 5.4 percent compared to 3.8 percent in the February forecast.

If the DRI Control scenario comes true, and the Minnesota economy tracks it as Finance Department economists expect, there will be a slowdown in 1999 which will be concentrated in agriculture, in some industries serving agriculture, and in capital goods manufacturing. Employment growth will slow by about one percentage point compared to 1998. But, unless there is an unexpected increase in migration into the state, employers will continue to have difficulty finding workers. The softening economy and low inflation will lead to less upward pressure on wages which is likely to be offset by stronger gains in benefit costs than in 1998.

Agriculture

Reduced Asian demand and good harvests have sent farm prices plunging to below the break even point for many crop and livestock farmers. According to the *Pioneer Press*, farm income prospects for Minnesota grain producers are the lowest since the mid 1980s. Finance Department economists believe that, unless there are significant crop failures in the U.S. or elsewhere, farm incomes are likely to remain depressed for the foreseeable future because Asian demand is unlikely to rebound soon. The Minnesota forecast recognizes the disaster relief program approved in October and assumes that the acceleration of production flexibility contract payments will continue through 2001.

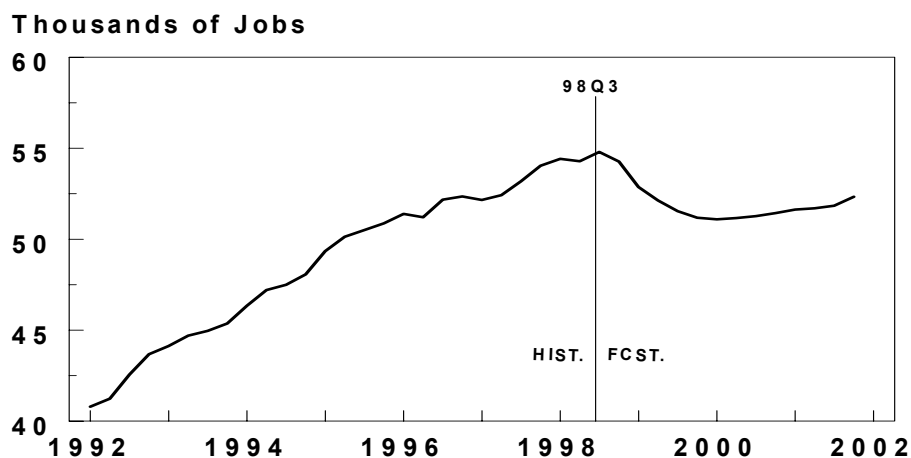
Construction

Housing and office building construction will be bright spots in the Minnesota economy during 1999. By early November, real estate sales had already set an annual record in 1998 for the third year in a row. Strong real estate sales are reflected in housing starts which a recent press article indicates are up 21 percent in the Twin Cities for the first 10 months of 1998. In 1999, starts are expected to have another good year provided interest rates remain low and the economy continues to expand. Slower jobs growth expected in 1999 and 2000, however, means starts will begin to slip from current high levels in late 2000.

During 1999, office construction will offset weakness in other commercial markets. A mid-October *Star Tribune* article indicates that the major buildings going up in Minneapolis will

increase available top rated office space by at least 30 percent. There are also other major projects underway in Minneapolis and St. Paul. Much of this activity will carry over into 2000 before beginning to wind down. Currently, most industry observers do not expect another boom in heavy construction to soon follow.

Employment in Minnesota's Industrial Machinery Sector



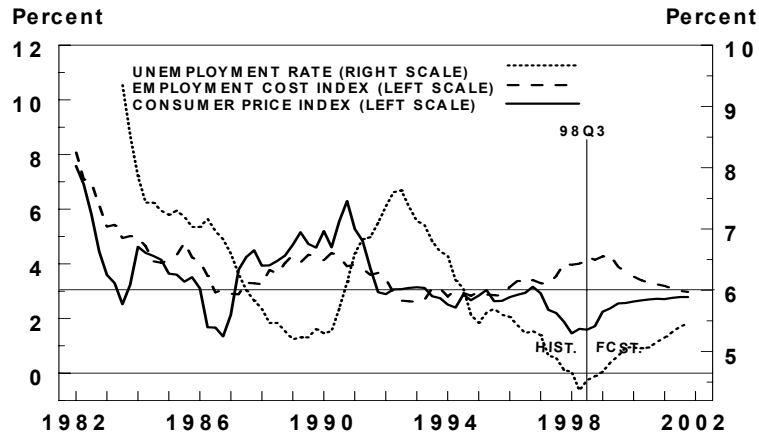
If DRI's November Control scenario comes true and the Minnesota economy tracks it as Finance Department economists expect, employment in Minnesota's industrial machinery sector will soon begin to decline.

Manufacturing

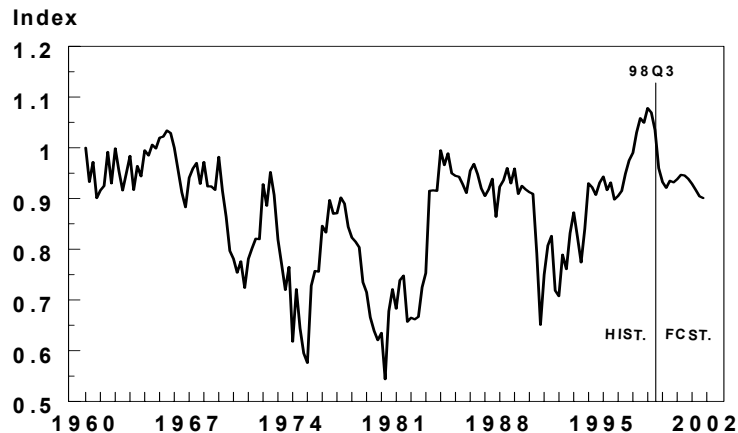
In the November Control forecast, the combined impact of a burgeoning trade deficit, a business investment slowdown, and a cooling housing market slow the U.S. economy sharply in early 1999. If this scenario comes true and the state economy tracks it as Finance Department economists expect, there will be reduced demand for Minnesota's manufactured goods, particularly industrial machinery sold nationwide and overseas. While there should not be massive layoffs, employment in the industrial machinery and electric machinery sectors will remain below 1998 levels through 2001.

Selected National Economic Indicators

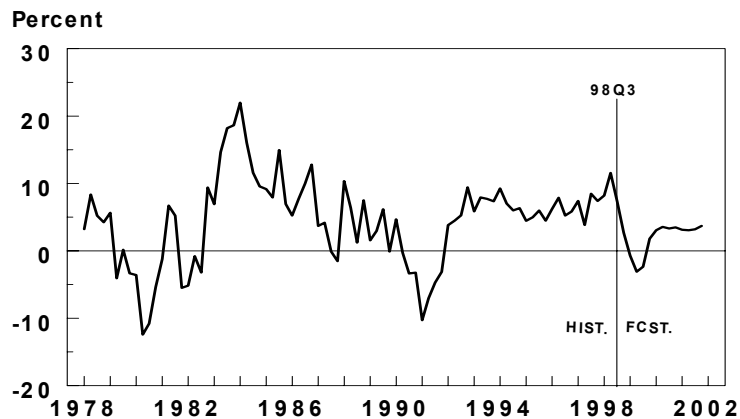
INFLATION AND UNEMPLOYMENT



INDEX OF CONSUMER SENTIMENT



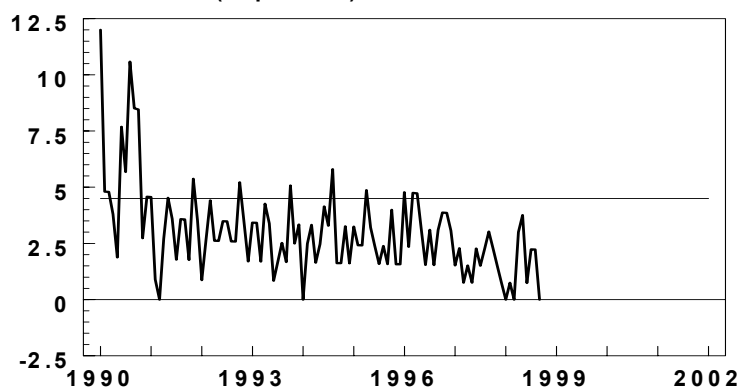
GROWTH IN REAL CONSUMER DURABLES SPENDING



Selected National Economic Indicators

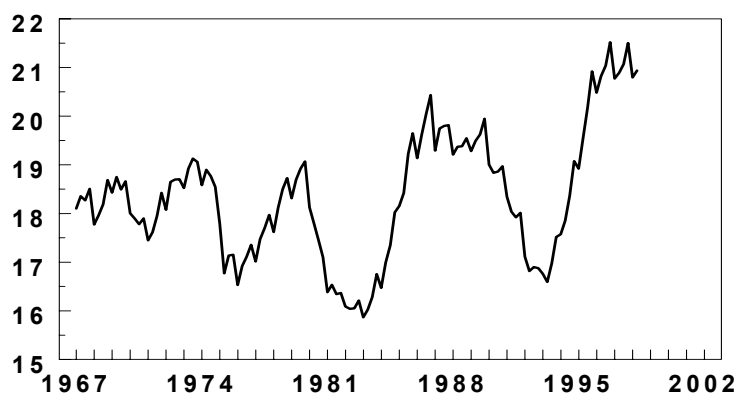
CONSUMER PRICE INDEX

Annualized rate (in percent)



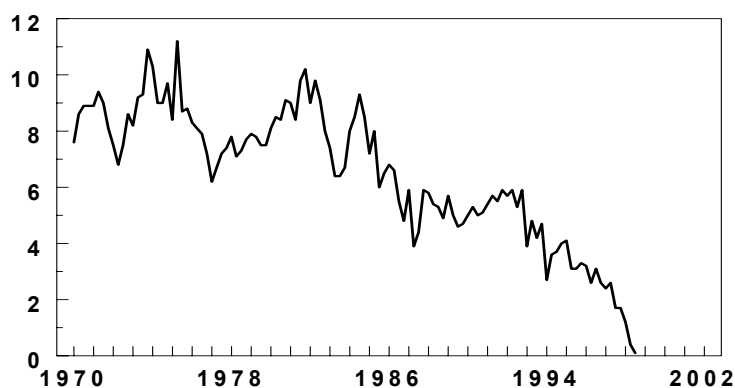
INSTALLMENT CREDIT OUTSTANDING AS A PERCENT OF DISPOSABLE INCOME

Percent



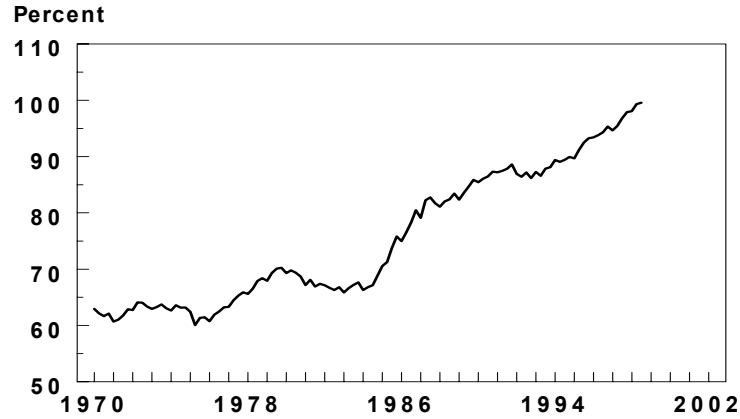
SAVING AS A FRACTION OF DISPOSABLE INCOME

Percent

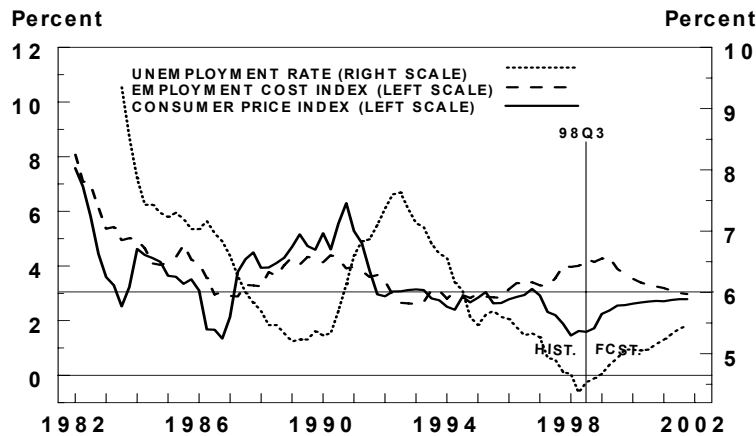


Selected National Economic Indicators

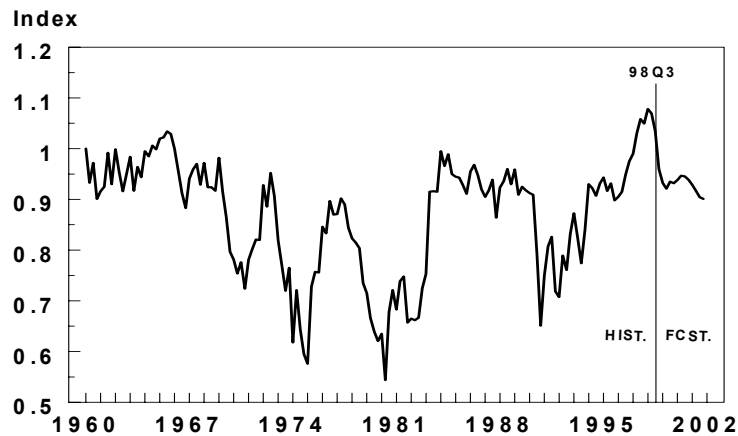
HOUSEHOLD FINANCIAL LIABILITIES AS A SHARE OF DISPOSABLE INCOME



INFLATION AND UNEMPLOYMENT

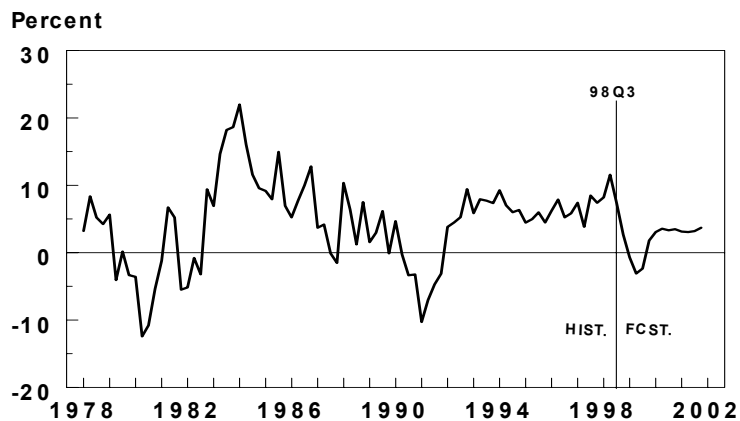


INDEX OF CONSUMER SENTIMENT

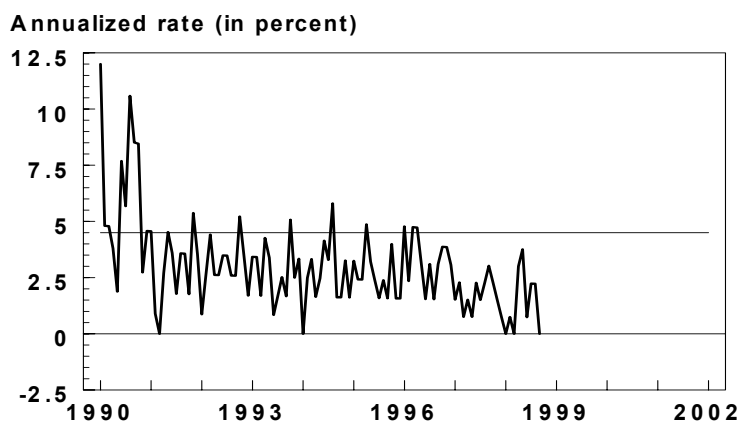


Selected National Economic Indicators

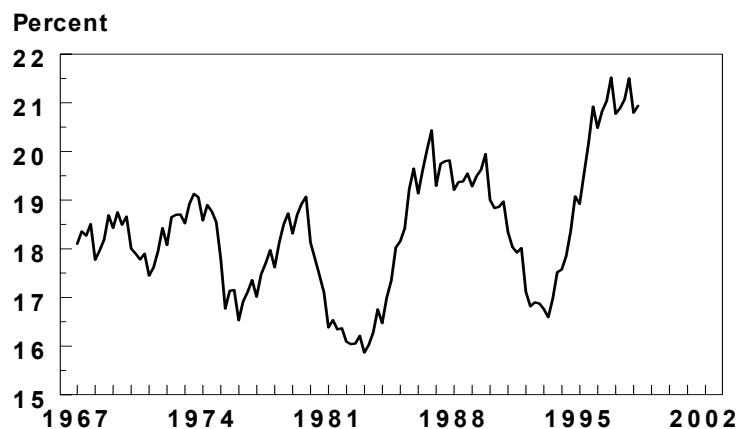
GROWTH IN REAL CONSUMER DURABLES SPENDING



CONSUMER PRICE INDEX

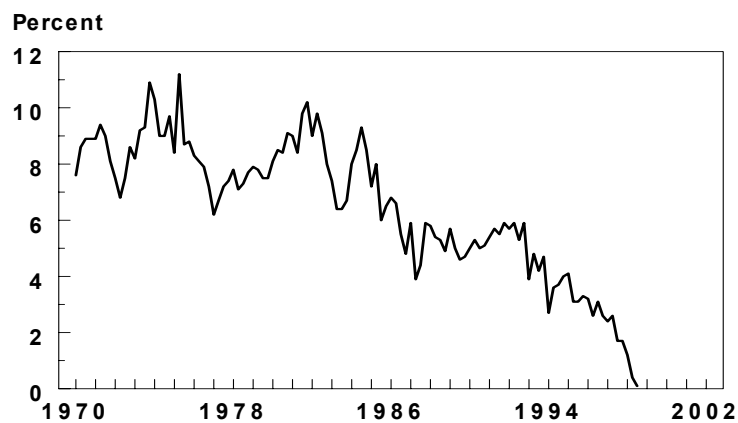


INSTALLMENT CREDIT OUTSTANDING AS A PERCENT OF DISPOSABLE INCOME

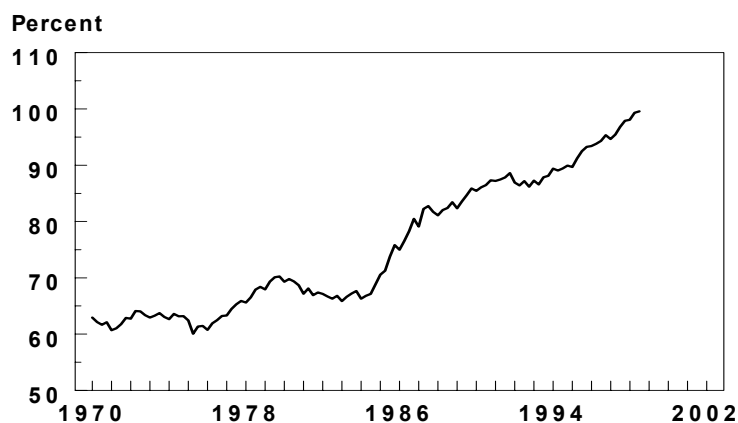


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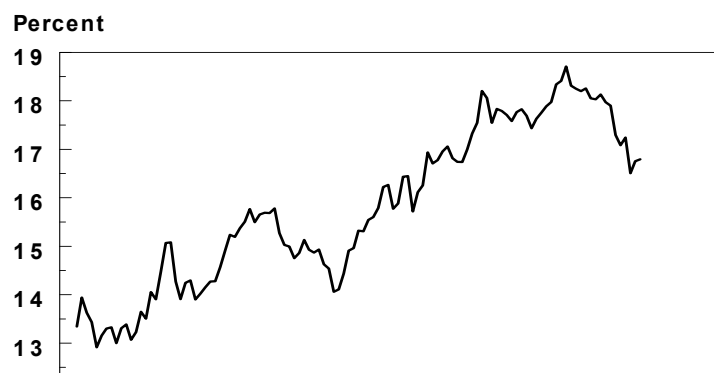
SAVING AS A FRACTION OF DISPOSABLE INCOME



HOUSEHOLD FINANCIAL LIABILITIES AS A SHARE OF DISPOSABLE INCOME

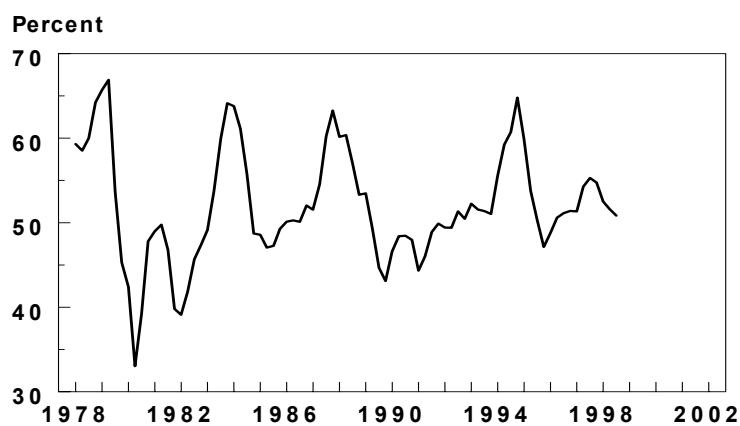


HOUSEHOLD FINANCIAL LIABILITIES AS A SHARE OF NET WORTH

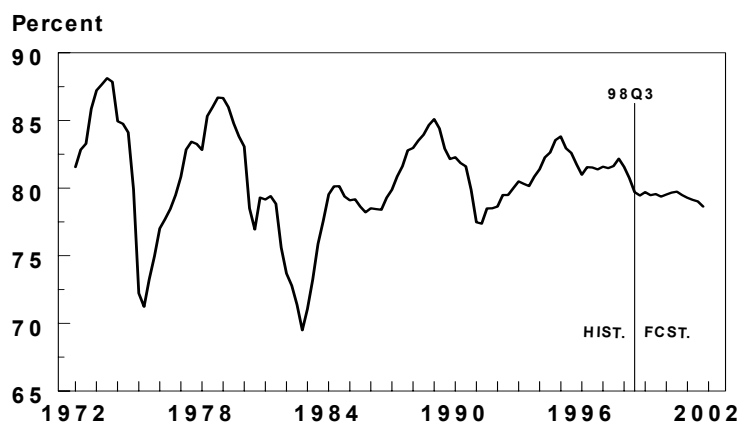


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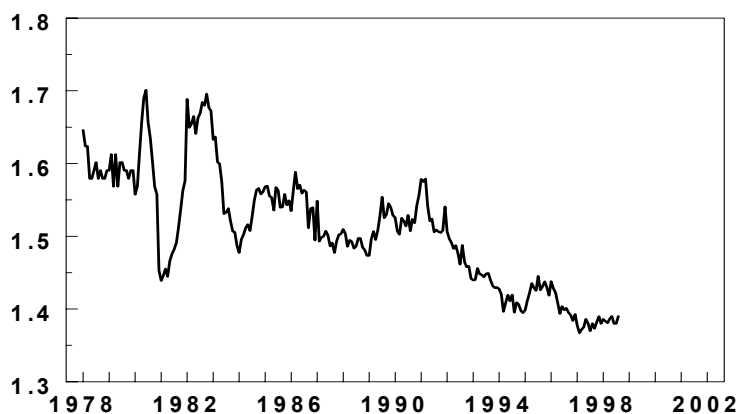
PROPORTION OF COMPANIES
RECEIVING SLOWER DELIVERIES



MANUFACTURING CAPACITY UTILIZATION

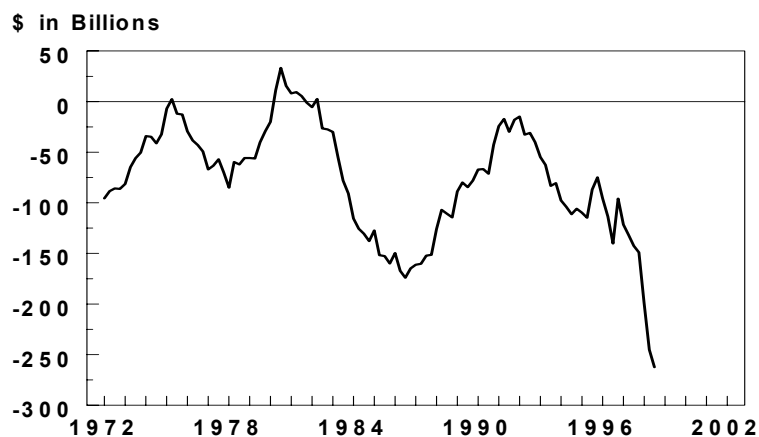


MANUFACTURING AND TRADE
INVENTORY TO SALES RATIO

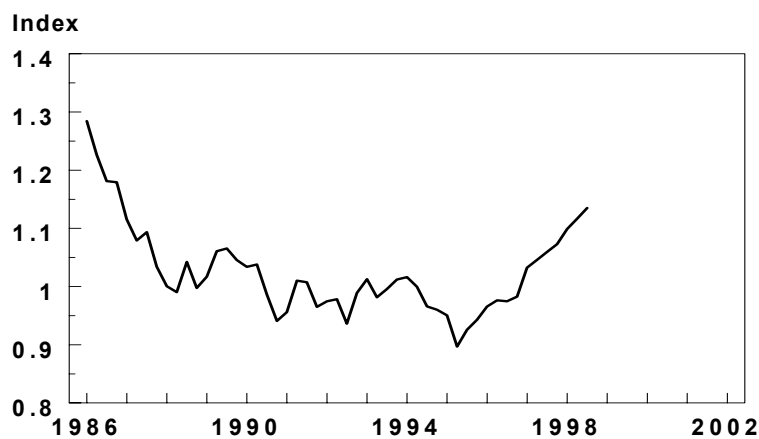


Selected National Economic Indicators

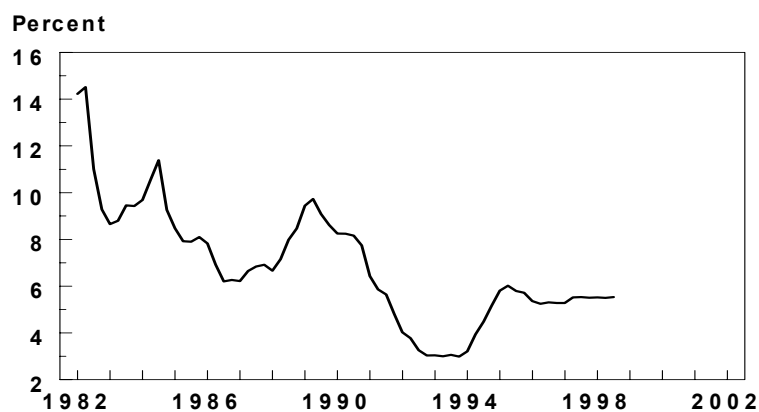
U.S. TRADE BALANCE (\$1992)



TRADE-WEIGHTED VALUE OF THE DOLLAR

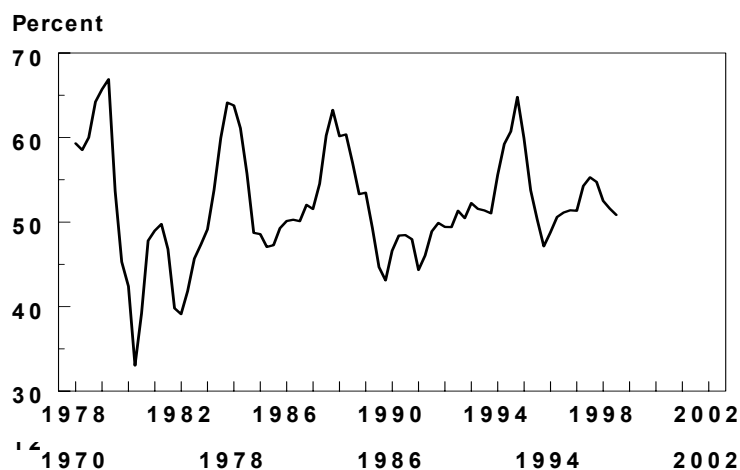


FEDERAL FUNDS RATE

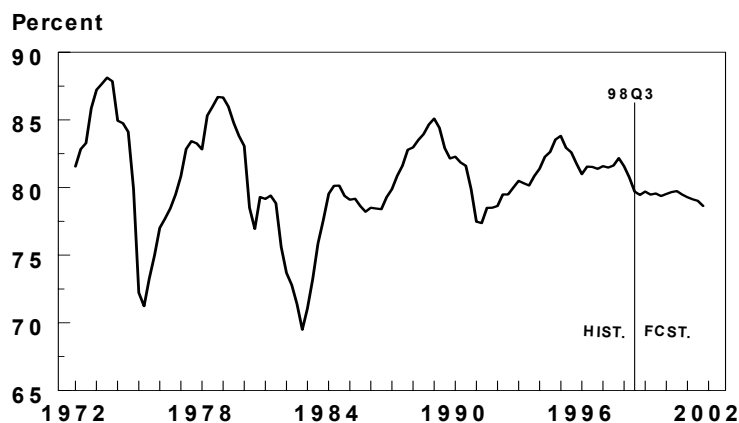


Selected National Economic Indicators

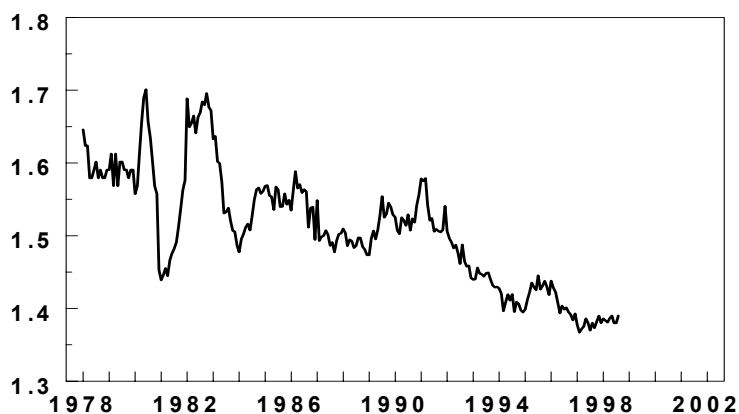
PROPORTION OF COMPANIES
RECEIVING SLOWER DELIVERIES



MANUFACTURING CAPACITY UTILIZATION

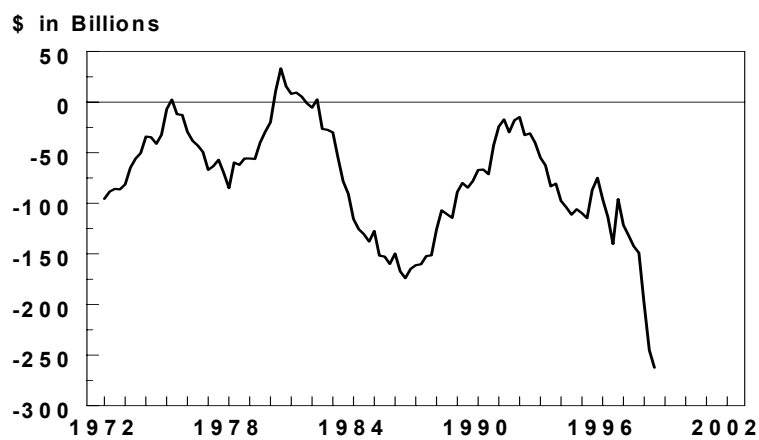


MANUFACTURING AND TRADE
INVENTORY TO SALES RATIO

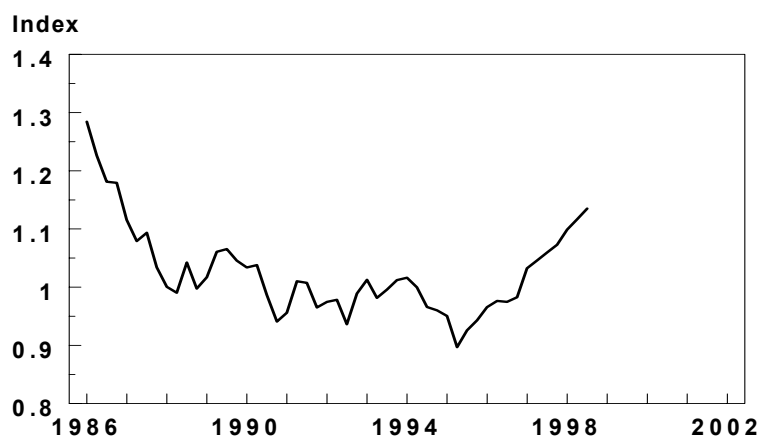


Selected National Economic Indicators

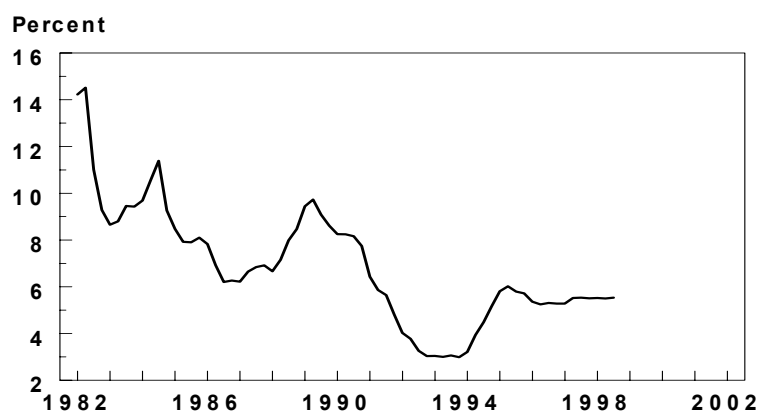
U.S. TRADE BALANCE (\$1992)



TRADE-WEIGHTED VALUE OF THE DOLLAR



FEDERAL FUNDS RATE



ISSUE HIGHLIGHT

The Cost of a Recession

Americans are currently reaping the benefits from the second longest economic expansion of the post-war era. By January the U.S. economy will have gone 93 months without a recession, about twice as long as is typical between economic downturns. This extended period of economic growth has produced low unemployment, rising wages, and a strong stock market. It has also reduced welfare caseloads and created budget surpluses for the federal and state governments.

Most forecasters expect economic growth to continue through at least the turn of the century, but the risk of a recession during the 2000-01 biennium has increased dramatically during the past 12 months. In its November forecast DRI, Minnesota's advisor on the national economy, warned that the probability of a recession before the end of the year 2000 is nearing 50 percent. The list of concerns is well known: Asia's economic problems remain unsolved, capital markets are weaker and more vulnerable than in the recent past, and the outlook for Latin America's economies is more fragile than a year ago. In the short term the health of the global economy rides largely on the continued strength of the U.S. economy, and U.S. economic prosperity depends in large part on further growth in consumer spending. A slowdown in consumer spending could easily produce a recession early in the 2000-01 biennium.

Prudent Financial Management Will Allow for Unexpected Contingencies

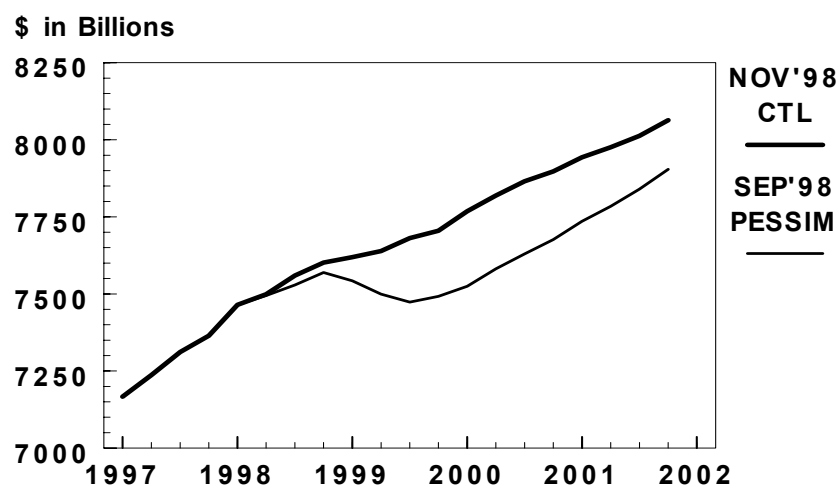
Since a recession's onset is seldom recognized until after it is well underway, it is likely that the budget for the next biennium will be enacted and signed into law before the current economic uncertainty is resolved. This makes it vital that the next Governor and Legislature develop a strategy to deal with the revenue shortfalls and expenditure increases which would accompany any economic downturn. To assist the Governor-elect and the next Legislature in evaluating the risks a recession would pose to Minnesota's finances, Governor Carlson instructed the Finance Department to include in its November forecast estimates of the revenue losses and expenditure increases which might occur should a recession strike early next year.

Possible Budget Shortfall of \$1.5 Billion for 2000-01 Biennium in Early Recession Scenario

Minnesota is currently well positioned to deal with an economic slowdown. The state will enter the next biennium with a budget reserve of more than \$622 million dollars, a separate \$350 million cash flow account, and an available cash balance of more than \$953 million. But, the tax cuts and spending increases approved in the next legislative session will almost certainly drop that available balance to much more modest levels, leaving the state's budget reserve as the primary cushion against the financial strains which would accompany a recession.

The Finance Department's analysis shows that even a modest recession would easily exhaust the budget reserve and the available cash balances, leaving the state with a budget deficit later in the biennium. Revenue losses associated with a recession similar to that contained in DRI's September Pessimistic Scenario could reduce state revenues by more than \$1.3 billion between now and the close of the 2000-01 biennium. In addition, human services expenditures, principally for medical assistance could increase by as much as \$180 million. The combined impact of revenue shortfalls and expenditure increases under this scenario reached a total of \$1.5 billion, two and one half times the current budget reserve.

**A Recession Would Reduce Revenues and Increase Expenditures
Through the Entire 4 Year Budget Planning Horizon (GDP \$92)**



Recession impacts were simulated based on the DRI's September Pessimistic Scenario. In that scenario the Asian crisis deteriorates sharply and Latin American also falls into recession. Foreign currencies weaken against the dollar leading to lower U.S. corporate earnings and a drop in the stock market. Consumers then cutback on their spending due to increased job uncertainty, and falling wealth. The resulting recession begins in the first quarter of 1999 and lasts through the third quarter of 1999. During that time real GDP falls by about 2 percent, or \$150 billion. Because of the low inflation rate nominal GDP also falls during that period. Although this is a relatively mild recession, and even though the economy begins to grow in the second quarter of fiscal 2000, it takes nearly 18 months for nominal GDP levels to once again reach the level observed in the fourth quarter of 1998. The gap between the economic activity expected in that recession the baseline scenario and that projected in the baseline scenario does not close through the end of the 2002-03 biennium. At the end of the 2000-01 biennium, real GDP remains \$232 billion below the Control projection.

Income Tax Receipts Would Fall by \$519 Million, Sales Taxes by \$550 Million Through 2001

In recessions some workers are laid off and hours are cut back for others. The result is much slower growth in individual income tax receipts than would be expected under normal conditions. The layoffs and downsizing create concern about job security throughout the labor force, producing slower growth in consumer spending, and thus sales tax and motor vehicle excise tax receipts fall as well.

In this recession scenario income tax revenue falls by a total of \$519 million (3.3 percent), in FY 1999, 2000, and 2001, the three fiscal years covered in the current forecast. Losses in fiscal 1999 are small because the recession does not begin until midway through the fiscal year. But the losses compared to the baseline forecast increase in 2000 and 2001, even after the economy again begins to grow. Sales tax receipts were projected to fall by \$550 million, corporate income taxes by \$202 million and the motor vehicle excise tax by \$36 million. The decline in receipts from the state's four major revenue sources totaled \$1.290 billion, or about 4.3 percent of total revenues from these taxes for the three years in question. Revenues from other, smaller tax sources and non-tax revenues, which total about \$900 million per year were projected to fall by \$54 million over the three year forecast horizon.

Revenue Losses in Recession Scenario

\$ (in Millions)

| | <u>FY 1999</u> | <u>FY 2000</u> | <u>FY 2001</u> | <u>Total</u> |
|--------------------------|----------------|----------------|----------------|--------------|
| Individual Income Tax | 38 | 155 | 326 | 519 |
| Sales Tax | 15 | 160 | 375 | 550 |
| Corporate Income Tax | 3 | 95 | 86 | 184 |
| Motor Vehicle Excise Tax | -- | 20 | 17 | 37 |
| Total Major Revenues | 56 | 430 | 804 | 1,290 |
| Other | <u>1</u> | <u>17</u> | <u>36</u> | <u>54</u> |
| Total | 57 | 447 | 840 | 1,344 |

The revenue impact of a recession was estimated by taking the difference between revenues projected in a baseline scenario based on the September DRI Control, and the revenues projected in a recession scenario based on DRI's September Pessimistic alternative. Estimates for particular taxes were prepared using the same methodology as used to prepare the out-year revenue planning estimates. That methodology is described in more detail in the section describing the revenue planning estimates for the 2002-03 biennium.

As with all revenue planning estimates the amounts projected are only a guide to the expected revenue impact, not a guarantee of a specific level of revenues. Different recession scenarios will yield different revenue impacts. A more severe recession would produce a larger shortfall, while a milder recession would disrupt state finances less. In general, recessions occurring later in the biennium will have a smaller impact on the 2000-01 biennium, but budget shortfalls in 2002-03 and beyond would be larger. Often recessions are accompanied by large drops in capital gains realizations as well as reductions in economic

activity. Any decline in capital gains realizations would add significantly to the estimated revenue losses.

Human Services Expenditures Could Increase \$180 Million in Recession

A recession also will increase demand for state entitlements, adding \$107 million to General Fund expenditures during FY 1999-2001 and \$73 million in federal block grant spending. These increases would be ongoing, increasing spending by similar amounts through FY 2002-2003.

Current caseloads for health and income supports are relatively low due to the strong job market. However, a recession would lower many families' income and they would once again be eligible for state supports. Non-DHS programs, such as child care and job training, would also see an increase in demand.

The impact of a recession will be most visible in enrollment in the Minnesota Family Investment Program (MFIP). The number of MFIP recipients has been dropping for several years, due to greater job opportunities and program changes. In 1993, the AFDC program had an average of 190,000 recipients per month. Just six years later, MFIP which replaced AFDC, expects only 150,000 recipients per month, a decrease of over 20%. A recession would end this trend and add roughly 15,000 persons to the program by FY 2001.

General Fund cost increases are largely generated by health care expenditures. The new MFIP enrollees are automatically eligible for health care benefits, though all eligibility segments would experience some increase. By FY 2001, Medical Assistance (MA) enrollment would rise by nearly 24,000 persons and General Assistance Medical Care (GAMC) would grow by 3,000 persons.

Expenditure Increases Due to Recession

| State and Federal Funds (\$ in millions) | | | | |
|---|----------------|----------------|----------------|----------------|
| Program | <u>FY 1999</u> | <u>FY 2000</u> | <u>FY 2001</u> | <u>Total</u> |
| MA (State Share) | \$0.7 | \$18.2 | \$41.3 | \$60.2 |
| GMAC | 0.4 | 12.6 | 20.4 | 33.4 |
| Other State Cost | 1.3 | 5.8 | 6.7 | 13.8 |
| MFIP - Federal | <u>1.8</u> | <u>25.1</u> | <u>46.2</u> | <u>73.1</u> |
| Total | \$4.2 | \$61.7 | \$114.6 | \$180.5 |

The unequal distribution of state expenditures is due in part to how programs draw matching funds from the federal government. In Medical Assistance (MA), the federal match increases with each state dollar spent. Cost increases are shared by state and federal payments. On the other hand, the MFIP federal match depends upon a complicated "maintenance of effort". In this recession scenario, all additional MFIP spending would be paid by increased draws on federal block grant funds.

ISSUE HIGHLIGHT

Tobacco Settlement Revenue

On May 8, 1998, Minnesota settled its lawsuit with the tobacco industry, resulting in estimated revenues to the state of \$6.1 billion over the next 25 years. Payments began in FY 1998 and will continue into perpetuity. A small portion of the settlement has been set aside by the courts for specific purposes. The balance of the settlement is to be deposited into the state's general fund as nondedicated revenues. The payments have the following components:

■ **Dedicated Payments**--\$202 million is dedicated for two specific purposes: research and smoking cessation. The first payment was received in FY 1998. Since these payments are being administered by the courts, and are not a part of the state's general fund revenues, they are not included in the graph below.

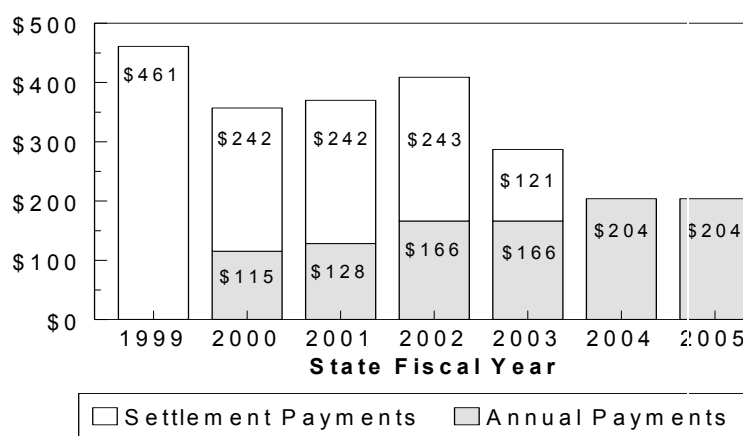
■ **Annual Payments**--These payments are ongoing revenues to the state's general fund, beginning with \$114.8 million in FY 2000, and increasing to \$204 million in FY 2004, and each year thereafter in perpetuity.

■ **Settlement Payments**--These payments are one-time revenues, beginning in FY 1999 and ending in FY 2003, that total \$1.3 billion.

Minnesota General Fund Tobacco Settlement Revenues

FY 1999-2005

(\$ in millions)



During the 1998-1999 biennium, the state's general fund will receive \$461 million from the tobacco industry. Total revenues through F.Y 2003 are expected to be \$1.884 billion. These revenue estimates will be affected in future years by inflationary adjustments and fluctuations in the U.S. tobacco market.

Revenues received by the state must be appropriated by the legislature and approved by the governor before they can be spent. In addition, the settlement requires the Attorney General to request that \$655 million, over a five year period, be allocated to a public health foundation established by the courts. This request must also be appropriated by the legislature and approved by the governor if it is to take effect.

In addition to monies received by the state treasury, the settlement establishes two other accounts for the dedicated payments. These accounts are to be administered by the court and are not subject to the appropriation process. These non-state funds include a *Smoking Cessation Account* established with a one-time payment of \$102 million and a *National Research Account* funded with \$100 million over ten years. A nonprofit public health foundation, Minnesota Partnership for Action Against Tobacco (MNPAAT), has been created to administer these funds.

Budget Update and Outlook

FY 1998-99 Budget Status

Unforeseen tobacco settlement funds, an increase in forecast revenues, and a reduction in forecast expenditures combined to increase the projected FY 1998-99 ending balance by \$1.526 billion. Including the \$35 million balance estimated at the end of the 1998 session yields a preliminary available balance of \$1.562 billion. That balance is automatically reduced by statutory provisions that allocate the first \$609 million of any forecast balance. After those allocations the estimated ending balance on June 30, 1999 is \$953 million.

The 1998 legislature specified that the first \$9 million of any forecast balance be used to restore Budget Reserve funding that was used to assist in paying crop insurance premiums for farmers affected by flood and storm damage. The next \$200 million of any balance must be deposited in a new tax reform and reduction account for future use. Finally, up to \$400 million is designated to convert general obligation bond authorizations from the last capital budget to general fund cash financing.

FY 1998-99 Budget Summary After Statutory Allocations*

(\$ in millions)

| | End of 1998 Session | November 1998 | Change | |
|-----------------------------|------------------------|------------------|--------------|---|
| Beginning Balance | \$1,995 | \$1,995 | \$0 | |
| Revenues | 20,123 | 20,855 | 732 | |
| Tobacco Settlement | | 461 | 461 | |
| Transfers, other | 854 | 925 | 71 | |
| Subtotal- Current Resources | 20,977 | 22,241 | 1,264 | |
| Estimated Expenditures | 21,545 | 21,249 | (296) | |
| Convert bonds to cash | 0 | 400 | 400 | * |
| Subtotal- Expenditures | 21,545 | 21,649 | 104 | |
| Balance Before Reserves | 1,427 | 2,587 | 1,160 | |
| Reserves: | | | | |
| Cash Flow Account | 350 | 350 | 0 | |
| Budget Reserve | 613 | 622 | 9 | * |
| Property Tax Reform Acct | 331 | 330 | (1) | |
| Tax Reform & Red. Acct | 0 | 200 | 200 | * |
| Dedicated Reserves | 97 | 132 | | |
| Available Balance | \$35 | \$953 | \$918 | |

Current resources increase \$1.264 billion, including \$461 million in tobacco settlement payments (which phase out over 5 years).

Forecast expenditures decline \$296 million from end of session estimates. After allocating \$400 million to capital projects, a net increase of \$104 million results. Almost all categories of state spending are actually forecast to decline, most notably K-12 education (\$39 million), health care (\$173 million), family support programs (\$20 million), and debt service (\$26 million).

Dedicated reserves increase by \$35 million over end of session estimates; \$34 million is attributable to balances carried forward into FY 1999 by the Minnesota State Colleges and Universities (MnSCU) which increases MnSCU's reserve balance to \$127 million.

FY 2000-2001 Budget Forecast

The FY 2000-01 revenue forecast is based on DRI's November 1998 Control forecast. This is the first actual forecast of revenues for the 2000-01 biennium. The revenue projections available during the 1998 legislative session were only planning estimates prepared by extrapolating from the 1998-99 base. Expenditure estimates are based on current law adjusted for enrollment and caseload changes and include an adjustment of 2.5 percent per year for estimated discretionary inflation.

FY 2000-01 Biennial Budget Forecast (\$ in millions)

| | FY 1998-99 | FY 2000-01 | Change |
|-----------------------------|----------------|----------------|----------------|
| Beginning Balance | \$1,995 | \$2,587 | \$592 |
| Revenues | 20,855 | 23,248 | 2,393 |
| Tobacco Settlement | 461 | 727 | 266 |
| Transfers, other | 925 | 663 | (262) |
| Subtotal- Current Resources | 22,241 | 24,638 | 2,397 +10.8% |
| Expenditures | 21,649 | 22,595 | 946 + 4.4% |
| Balance Before Reserves | 2,587 | 4,629 | 2,042 |
| Reserves: | | | |
| Cash Flow Account | 350 | 350 | 0 |
| Budget Reserve | 622 | 622 | 0 |
| Property Tax Reform | 330 | 0 | (330) |
| Acct | | | |
| Tax Reform & Red. | 200 | 200 | 0 |
| Acct | | | |
| Dedicated Reserves | 132 | 133 | 1 |
| Ending Balance | \$953 | \$3,324 | \$2,371 |

Current resources are projected to increase \$2.397 billion in FY 2000-01, including \$727 million in tobacco lawsuit revenues. Projected expenditures increase by \$946 million, including \$799 million in discretionary inflation. Significant spending increases are forecast in K-12 education (\$697 million), property tax aids and credits (\$597 million), and health care programs (\$657 million); these increases are partially offset by a decline of \$901 million in one-time capital projects spending.

FY 2002-03 Planning Estimates

The planning estimates for FY 2002-03 are materially different from the short-term forecasts for the current and FY 2000-01 bienniums. Projection methods are different and the longer term projections carry a higher degree of uncertainty and an inherently larger potential range of error. This is the first set of planning estimates for the FY 2002-03 biennium.

Planning estimates for FY 2002-03 are presented to help budget decision makers identify longer term state finance issues. Revenue projections are based on DRI's Summer 1998 Cyclelong and November 1998 Control forecasts. Expenditure projections assume current laws and policies continue unchanged, and adjust for caseload and enrollment changes. The expenditure estimates also add 2.5 percent per year to the FY 2001 budget planning estimates for discretionary inflation. The estimates make no assumptions about the Governor's FY 2000-01 budget proposals for the 1999 session.

FY 2002-03 Long Term Planning Estimates

(\$ in millions)

| | FY 2000-01 | FY 2002-03 | Change | |
|-----------------------------|-------------------|-------------------|----------------|-------|
| Beginning Balance | \$2,587 | \$4,629 | \$2,042 | |
| Revenues | 23,248 | 25,187 | 1,940 | |
| Tobacco Settlement | 727 | 696 | (32) | |
| Transfers, other | 663 | 734 | 71 | |
| Subtotal- Current Resources | 24,638 | 26,617 | 1,979 | +8.0% |
| Expenditures | 22,595 | 24,508 | 1,913 | +8.5% |
| Balance Before Reserves | 4,629 | 6,738 | 2,109 | |
| Reserves: | | | | |
| Cash Flow Account | 350 | 350 | 0 | |
| Budget Reserve | 622 | 622 | 0 | |
| Property Tax Reform Acct | 0 | 0 | 0 | |
| Tax Reform & Red. Acct | 200 | 200 | 0 | |
| Dedicated Reserves | 133 | 133 | 0 | |
| Ending Balance | \$3,324 | \$5,433 | \$2,109 | |

Current resources are projected to increase \$1.979 billion in FY 2002-03, including \$696 million in tobacco lawsuit revenues. Projected expenditures increase by \$1.913 billion,

including an additional \$1.172 billion in discretionary inflation. Significant forecast increases over FY 2000-01 are limited to property tax aids and credits and health care, which increase 10.2 percent and 20.9 percent respectively.

These projections are not intended to predict a balanced or unbalanced budget in the future. Their purpose is to assist in determining how well ongoing expenditures will match revenues based on trend projections of Minnesota's economy and what it will cost to maintain the same programs.

Revenue Forecast FY 1998-99

Current general fund resources for the 1998-99 biennium excluding revenues received from the tobacco settlement are now estimated to total \$21.780 billion, \$803 million (3.8 percent) more than end-of-session estimates. Tobacco settlement payments will provide an additional \$461 million to the general fund during the current biennium. The forecast revisions combined with the tobacco settlement payments increase Minnesota's general fund revenues for the current biennium by a total of \$1.264 billion from end-of-session estimates.

The individual income tax provided the largest portion of the additional revenues, up \$519 million (5.6 percent), from end-of-session estimates. The forecast for corporate income tax receipts was reduced by \$94 million. Forecasts for sales tax and motor vehicle tax revenues were raised by \$71 million and \$64 million respectively. Revenues from the four major taxes are now forecast to reach \$18.748 billion during the current biennium, up \$561 million from end-of-session estimates. Estimates for other tax and non-tax revenues excluding the tobacco payments were increased by \$171 million, and dedicated revenues, transfers, and prior year adjustments grew by a total of \$71 million.

FY 1998-99 Revenue Forecast (\$ in millions)

| | <u>FY96-97</u> <u>Biennium</u> | <u>FY 98</u> | <u>FY 99</u> | <u>FY98-99</u> <u>Biennium</u> |
|---------------------------|-----------------------------------|---------------|---------------|-----------------------------------|
| Revenues | | | | |
| Individual Income Tax | 8,904 | 4,747 | 4,996 | 9,743 |
| Sales Tax | 5,914 | 3,252 | 3,414 | 6,665 |
| Corporate Income Tax | 1,383 | 752 | 707 | 1,460 |
| Motor Vehicle Excise Tax | 783 | 445 | 435 | 880 |
| Four Major Taxes | 16,984 | 9,196 | 9,552 | 18,748 |
| Other Revenues | 1,842 | 1,063 | 1,044 | 2,107 |
| Tobacco Settlement | -- | -- | 461 | 461 |
| Net Non-dedicated Revenue | 18,826 | 10,259 | 11,057 | 21,316 |
| Other Resources | 777 | 486 | 439 | 925 |
| Current Resources | <u>19,603</u> | <u>10,745</u> | <u>11,497</u> | <u>22,241</u> |

Net-non dedicated revenues for 1998-99 are now projected to grow by 13.2 percent over 1996-97. After adjusting for the tobacco settlement revenue growth is now expected to be 11.1 percent. Biennial growth rates for the income tax and the sales tax are now expected to be 9.4 percent and 12.7 percent respectively.

Individual Income Tax

Individual income tax receipts for the 1998-99 biennium are now forecast to total \$9.743 billion, up \$519 million (5.6 percent) from end-of-session estimates. Revenues were above forecast by \$222 million in FY 1998, and they are projected to exceed the previous forecast by \$297 million in FY 1999.

Wages and capital gains were the source of much of the variance. The 1997 base level for Minnesota wages was increased, consistent with the revised estimates of Minnesota wages reported by the U.S. Department of Commerce in mid-1998. Expected growth rates for Minnesota wages in both 1998 and 1999 were also increased, reflecting the stronger than anticipated economic growth during the first three quarters of 1998 and DRI's improved outlook for the economy in 1999. Since wages account for more than 70 percent of the individual income tax base, relatively small percentage changes in either the base of the forecast, or the expected growth rate yield sizeable dollar changes in tax receipts. The increase in the wage forecast accounted for about one-third of the variance in the individual income tax for the 1998-99 biennium.

Much of the remainder of this biennium's income tax variance came from changes in forecast capital gains realizations. As reported last February, preliminary 1996 sample results caused the HITS model to overestimate reported 1996 tax liability by \$14 million. That gap was eliminated for 1997 and beyond by assuming that the entire gap came from the difference between Minnesota capital gains growth in 1996 and that for the rest of the nation.

This resulted in the 1997 growth rate for Minnesota capital gains being reduced to 14 percent, from the 25 percent rate previously assumed. At the time, that assumption appeared appropriate given uncertainty about the level of Minnesota capital gains in tax year 1996 other than those associated with large mergers and acquisitions and the uncertainty about tax year 1997 capital gains caused by a reduction in the federal capital gains tax rate.

Now, with the advantage of preliminary federal information about the actual composition of revenues for tax year 1997, that assumption was clearly too conservative. Early data on U.S. sources of tax year 1997 income show capital gains realizations growing by more than 40 percent from 1996 levels. The super-normal capital gains growth in 1997 resulted in higher than anticipated settle-up payments accompanying last April's 1997 tax returns. It also raised the base level of capital gains realizations substantially for tax year 1998, and all future tax years. The combination of stronger than anticipated capital gains growth in tax year 1997 and the higher base for 1998 accounts for about one third of the increase in individual income tax revenues in the current biennium.

Property tax rebate claims, to this point, remain less than projected resulting in lower than anticipated refunds on tax year 1997 income tax filings. Net income tax revenues were increased by \$78 million for the biennium to reflect the lower level of claims. This accounted for 15 percent of the individual income tax variance for the current biennium. The property tax rebate estimate will be re-visited in February after all current year 1997 tax returns have been processed.

Technical changes accounted for much of the remaining variance. Changes in the ratio of receipts to final liability added \$30 million to the forecast while taxes on fiduciary income increased by \$22 million. The remainder came from changes in various sources of non-wage income and deductions, and from minor technical changes including indexing at a lower rate.

This is the first forecast using the tax year 1996 sample as the base year for the simulation. An off-model adjustment of \$6.7 million was necessary to raise estimated liability to observed tax year 1996 liability. The 1996 sample excludes certain high income individuals with unusual and unsustainably high capital gain income in 1996. Additional liability of \$6.7 million was added off-model to tax year 1998 to reflect portfolio income for those taxpayers. Similar amounts were added for all future years in the forecast horizon.

As in February, no adjustment was made for possible reductions in individuals' withholding or estimated tax payments in anticipation of the state property tax rebate, nor were any reductions assumed in state withholding by those eligible for the federal child care tax credit first effective in tax year 1998.

Sales Tax

Net sales tax receipts are now projected to reach \$6.665 billion during the 1998-99 biennium, \$71 million (1.1 percent) more than end-of-session estimates. Much of the forecast gain reflects revenue already received. Gross sales tax receipts are now forecast to increase by \$108 million during this biennium, consistent with the higher economic growth already observed. To date, \$53 million of that expected increase has been collected. Sales tax refunds, are now projected by the Department of Revenue to total \$181 million during this biennium, \$43 million more than end-of-session estimates.

Corporate Franchise Tax

Corporate tax revenues for the 1998-99 biennium are now forecast to be \$1.459 billion, down \$94 million (6.0 percent) from end-of session estimates. Although the U.S. economy has been relatively unaffected by Asia's financial problems, the outlook for corporate profits has dimmed. DRI's November Control forecast of 1998 pretax profits was nearly 6 percent below February's, reflecting recently observed weakening of export sales and the narrowing of profit margins. There was a \$30 million negative variance in corporate taxes in FY 1998.

Corporate refunds were increased by \$19 million for FY 1999 due to an adverse judgement in *Rural American Bank v. Commissioner of Revenue*. This case extended eligibility for refunds under the Cambridge Bank decision to a set of banks formerly excluded. Expected settle-up payments for FY 1999 and all future years were reduced by \$5 million per year to reflect Minnesota Supreme Court rulings in *Hercules Inc., et. al. v. Commissioner of Revenue*, and *Firststar Corp. v. Commissioner of Revenue*. Those rulings effectively change the definition of corporate income subject to apportionment for companies domiciled outside Minnesota.

Motor Vehicle Excise Tax

Motor vehicle excise tax revenues are now projected to reach \$880 million during the 1998-99 biennium, up \$64 million (7.8 percent), from end-of-session estimates. Nationally, the value of sales of autos and light trucks during FY 1998 grew substantially faster than forecast in February leading to a \$27 million positive variance for the year. Forecast revenues for FY 1999 were also increased, reflecting the higher base level of sales.

Other Revenues

Other tax and non-tax revenues, other than the tobacco settlement payments are now expected to total \$2.107 billion during the current fiscal year, up \$170 million (8.8 percent) from end-of-session estimates. Nearly half the additional revenue came from an \$82 million increase in the investment income forecast. The investment income forecast for FY 1999 was increased by \$48 million, reflecting the actual income in FY 1998 of \$34 million, as well as the forecast for larger balances available for investment. Projected mortgage and deed tax revenues increased by \$35 million, reflecting both higher than previously forecast home sales and further mortgage refinancing activity beyond that forecast in February. The forecast for inheritance and estate was increased by \$33 million and the expected insurance gross premiums tax revenue was increased by \$18 million, consistent with current levels of receipts. Changes in the remaining taxes and non-tax revenues were small and usually reflected year-to-year variances.

Tobacco Settlement Payments

Tobacco settlement payments totaling \$461 million are expected during the current fiscal year. The first payment of \$240 million was made as required in September. A second \$221 million payment is due in early January 1999. Since none of the tobacco settlement was anticipated in the February forecast the entire amount of the settlement payments made to the general fund add to the forecast variance.

Revenue Forecast FY 2000-01

Total current resources, excluding tobacco settlement payments, are forecast at \$23.911 billion in the 2000-01 biennium, up \$653 million (2.8 percent) from end-of-session planning estimates. When combined with the \$727 million in tobacco settlement payments due in the coming biennium, general fund revenues for the 2000-01 biennium are now expected to exceed end-of-session planning estimates by \$1.380 billion. Total current resources for the 2000-01 biennium, including the tobacco settlement payments, are now forecast to be \$24.638 billion, up 10.8 percent over the 1998-99 biennium. The growth rate when the tobacco settlement is excluded is 9.8 percent.

This is the first official forecast of revenues for the 2000-01 biennium. Previously reported revenue projections for this biennium were only simple extrapolations of the 1999 base level revenues based on an expected 25 year average growth rate for the U.S. economy.

FY 2000-01 Revenue Forecast (\$ in millions)

| | <u>FY98-99 Biennium</u> | <u>FY 00</u> | <u>FY 01</u> | <u>FY00-01 Biennium</u> |
|---------------------------|------------------------------------|----------------------|----------------------|------------------------------------|
| Revenues | | | | |
| Individual Income Tax | 9.743 | 5.681 | 6.019 | 11.699 |
| Sales Tax | 6.665 | 3.576 | 3.745 | 7.322 |
| Corporate Income Tax | 1.460 | 661 | 691 | 1.352 |
| Motor Vehicle Excise Tax | 880 | 434 | 449 | 883 |
| Four Major Taxes | 18.748 | 10.351 | 10.905 | 21.256 |
| Other Revenues | 2.107 | 1.011 | 980 | 1.992 |
| Tobacco Settlement | 461 | 357 | 370 | 727 |
| Net Non-dedicated Revenue | 21.316 | 11.719 | 12.255 | 23.975 |
| Other Resources | 927 | 340 | 324 | 663 |
| Current Resources | <u>22,241</u> | <u>12,059</u> | <u>12,579</u> | <u>24,638</u> |

Individual income taxes show the greatest growth during the biennium, up nearly \$2 billion (20 percent) from levels forecast for the current biennium. Much of that increase is due to the effects of the property tax rebate programs on net receipts in both FY 1998 and FY 1999.

Those rebates reduced income tax liability by a total of \$890 million in the 1998-99 biennium. Under current law rebates will not be available in FY 2000. The result is that net income tax revenues will increase by nearly 14 percent. Forecast sales tax receipts increased by slightly less than 10 percent for the biennium, while corporate franchise tax revenues are expected to fall by 7.4 percent.

Large differences between end-of-session revenue planning estimates and the first official forecast for a biennium are not unusual. Those planning estimates extend for more than 36 months, and require individual income tax projections for five tax years. Unexpected events, such as federal tax law changes or this year's tobacco settlement which added \$727 million of unanticipated revenue to general fund revenues in the 2000-01 biennium of tobacco revenue can add materially to expected revenues. Other changes typically come from one of three sources. First, any change in the base level revenues for 1999, the year from which the extrapolations are made, will be carried forward intact into the future. In the current forecast, revised estimates of wages and salaries and capital gains in tax year 1997 added significantly to the individual income tax base throughout the forecast, adding revenues in both the 1998-99 and 2000-01 biennia. Similarly, a reduction in the forecast corporate profits for both 1998 and 1999, lowered the starting point for the 2000-01 forecast as well.

Differences between the economic growth rates used to extrapolate revenues in the planning estimate and that used in the forecast can magnify the differences due to a changed starting point. Growth rates assumed in preparing February's revenue planning estimates were generally slightly below the rates used in this forecast, although the majority of the gap between the planning estimates and this forecast was due to the increase in FY 1999 base levels.

Finally, growth rates in Minnesota may not track the national economic growth rates used in making the planning estimates. When the forecast is prepared, a separate model of the Minnesota economy is employed to produce Minnesota specific estimates of growth in wages, employment and personal income. In the planning estimates, revenues are projected based on U.S. average growth rates. In recent years, Minnesota has grown slightly faster than the U. S. averages.

Individual Income Tax

Individual income tax revenues in the 2000-01 biennium are forecast to total \$11.699 billion, up \$686 million (6.2 percent) from end-of-session planning estimates. The majority of the increased revenue is attributable to the same increase in the tax base which produced the additional revenue for the 1998-99 biennium. Employment and wages are both projected to grow at more subdued rates than in the recent past, consistent with projections of a slowing national economy. Capital gains realizations are forecast to grow substantially slower than in the recent past, averaging four percent per year for tax years 1999-2001. Net farm income is also assumed to remain below recent levels due to continued low grain prices. Wage and salary disbursements, which account for more than 70 percent of gross income in Minnesota, are expected to grow at a 5 percent annual rate over the next 3 years, slower than the 7 percent growth rate observed from 1996 through 1998.

Sales Tax

Net sales tax receipts for the 2000-01 biennium are expected to reach \$7.322 billion an increase of \$656 million (9.8 percent) over the forecast for 1998-99 biennium. Biennial

growth rates for consumers durables and business capital equipment, the two largest components of Minnesota's sales tax base were 10.2 percent and 10.9 percent respectively. The Department of Revenue's estimate of sales tax refunds for the biennium grew by \$74 million to \$356 million, consistent with recent revisions to the estimate for the 1999 fiscal year. The sales tax forecast exceeds end-of-session planning estimates by \$149 million or 2.1 percent.

Corporate Franchise Tax

Corporate tax revenues are forecast to total \$1.352 billion in the 2000-01 biennium, 7.4 percent less than forecast for 1998-99. In DRI's November Control forecast corporate pre-tax profits fall in both 1998 and 1999. When the lower base level of profits is used in the forecast, lower tax revenues result. The corporate income tax forecast for FY 2000 was reduced by \$20 million to reflect the conclusion of the refunds to be paid under the Rural American Bank decision. Corporate income tax revenues were reduced by an additional \$5 million per year to reflect the impact of the Hercules and Firststar cases on future revenues.

Motor Vehicle Excise Tax

Motor vehicle excise tax receipts for the 2000-01 biennium are forecast at \$883 million, up only 0.3 percent from FY 1998-99 levels. Department of Finance projections indicate a slowing in local sales of autos and light trucks, with dollar volume of taxable sales remaining relatively constant through the forecast horizon. Consumers have been active purchasers of autos in the past two years and as the economy slows during 1999, little growth in auto sales is expected. The motor vehicle excise tax forecast for FY 2000-01 is up \$58 million (7.1 percent) from the end-of-session planning estimates.

Other Revenues

Other tax and non tax revenues, excluding the tobacco settlement payments are forecast to total \$1.992 billion in the 2000-01 biennium, a drop of 5.5 percent from levels anticipated in the current biennium. While the investment income forecast for 2000-01 has increased, the forecast is less than that for the current biennium, since state resources are assumed to drop to only the authorized reserve level by the end of the next biennium.

Tobacco Settlement Payments

Tobacco settlement payments totaling \$727 million are expected during the 2000-01 biennium, \$357 million in FY 2000 and \$370 million in the following fiscal year. Since none of the tobacco settlement was anticipated in the February forecast the entire amount of the settlement payments made to the general fund adds to the forecast variance.

Revenue Planning Estimates FY 2002-03

The initial revenue planning estimate for the 2002-03 biennium projects current resources to total \$26.617 billion, 8.0 percent more than the forecast for the 2000-01 biennium. The four major taxes are expected to grow by 9.2 percent, while other tax and non-tax revenues are projected to by 0.8 percent from projected levels for 2000-01. A \$60 million decline in investment income and a \$32 million decline in scheduled tobacco settlement revenue are the sources of the slow growth in other revenues.

This baseline planning estimate is not an explicit forecast. It is simply an extrapolation of projected trends in the economy. Because of the way it is constructed, any changes in the base level of revenues for fiscal 1998, or any subsequent year through fiscal 2001 will be reflected in the revenue planning estimates for 2002 and 2003. Other things equal, stronger than anticipated growth in either of those years will add significantly to revenues available in the 2002-03 biennium. Similarly, should the economy grow more slowly than forecast during the next three years, the revenue outlook for 2002-03 will deteriorate.

These revenue planning estimates are only a guide to the level of future revenues, not a guarantee. If the economy remains strong through 2001, if projections of capital gains realizations for tax years 1998, 1999, and 2000 are accurate, and if recent technical adjustments to the income and sales tax models are appropriate these planning estimates are likely to underestimate future revenues. But if the economy fails to perform at the level anticipated in DRI's November Control, or, if capital gains realizations fail to reach the level projected, or if the technical adjustments were unnecessary, the planning estimates will overstate future revenues. Actual revenues could exceed or fall short of the planning estimates by as much as \$1.5 billion, depending on the economy's performance during the next 4 years.

The projected growth rate for FY 2002-03 revenues is less than that forecast for the 2000-01 biennium. The tobacco settlement, whose payments peak in the 2000-01 biennium, and the return to normal from the two \$500 million property tax rebate programs administered through the individual income tax system produced unusually high revenue growth in 2000-01 biennium. When those one time events are netted out revenue growth in 2002-2003 is only slightly below average.

FY 2002-03 Revenue Planning Estimates
(\$ in millions)

| | FY2001-02 | | | FY2002-03 |
|---------------------------|------------------------|----------------------|----------------------|------------------------|
| | <u>Biennium</u> | <u>FY2002</u> | <u>FY2003</u> | <u>Biennium</u> |
| Revenues | | | | |
| Individual Income Tax | 11.699 | 6.280 | 6.602 | 12.882 |
| Sales Tax | 7.322 | 3.891 | 4.041 | 7.932 |
| Corporate Income Tax | 1.352 | 704 | 761 | 1.466 |
| Motor Vehicle Excise Tax | 883 | 458 | 473 | 931 |
| Four Major Taxes | 21.256 | 11.333 | 11.877 | 23.210 |
| Other Revenues | 2.719 | 1.392 | 1.281 | 2.673 |
| Net Non-dedicated Revenue | 23.975 | 12.725 | 13.158 | 25.883 |
| Other Resources | 663 | 367 | 367 | 734 |
| Current Resources | <u>24,638</u> | <u>13,092</u> | <u>13,525</u> | <u>26,617</u> |

Estimates of 2002-03 revenues are based on DRI's Summer 1998 Cyclelong and November, 1998, Control forecasts. Nominal growth rates for variables used in projecting tax revenues were computed by multiplying the average real growth rate for each key series computed over the entire 25 year Cycle forecast horizon by the appropriate inflation estimate for that year taken from the November Control forecast.

Although DRI extended the forecast horizon for its Control forecast to 5 years, in October, 1996, there is still only fragmentary data on the reliability of their year four and year five forecasts. The Department of Finance has chosen to continue to use its previous methodology for preparing revenue planning estimates. Department economists will continue to evaluate the advisability of basing their long term planning estimates on the year four and year five projections from the DRI Control.

Individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth in the Cyclelong forecast. All elements of taxable income and all individual itemized deductions were assumed to grow at the growth rate for taxable personal income forecast by DRI. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 1999.

Future sales tax revenues were estimated by computing percentage growth rates for each of seven broad categories of products in the sales tax base. Those growth rates for both FY 2002 and FY 2003 were constructed using the estimated real growth real from DRI's Summer, 1998 Cycle forecast and inflation from the November, 1998, Control forecast. The growth rates were then weighted by the fraction of the expected 1999 sales tax base attributable to each category of purchases. The sum of the weighted growth rates was used

as a measure of expected growth in the sales tax base for 2002 and 2003.

Corporate tax receipts in Minnesota were estimated to grow at the same rate as the DRI's Control forecast of national before tax corporate profits. Minnesota's motor vehicle excise tax collections are expected to grow at the same rate as the national consumption of motor vehicles and parts. Planning estimates for other tax and non tax revenues were prepared by extrapolating existing trends.

It is impossible to anticipate the economy's performance three or four years in advance. Economic projections which look that far into the future can only be extrapolations of historical trends consistent with the current short term outlook. It is important to remember that the long term revenue planning estimate is only a guide to what revenues three and four years from now might be, not a guarantee of a specific level of revenues, and that there may be large positive or negative errors in the long term estimate.

Expenditure Forecasts FY 1998-2003

Current Biennium

The November, 1998 expenditure forecast for the current biennium totals \$21.649 billion, a \$104 million increase from the comparable estimates at the end of the 1998 legislative session. Most areas of state spending are now projected lower than the end-of-session estimates.

FY 1998-99 Expenditure Forecast (\$ in millions)

| | End of 1998 Session | <u>Nov. 1998</u> | <u>Difference</u> |
|---|----------------------------|-------------------------|--------------------------|
| <u>Estimated Spending by Function</u> | | | |
| Education/Children & Families | \$6,951 | \$6,912 | (\$39) |
| Property Tax Recognition | 109 | 109 | 0 |
| Post-Secondary Education | 2,451 | 2,444 | (7) |
| Property Tax Aids & Credits | 2,600 | 2,576 | (24) |
| Other Major Local Assistance | 1,022 | 1,011 | (11) |
| Health Care | 3,293 | 3,120 | (173) |
| Family Support | 537 | 517 | (20) |
| State Operated Institutions | 891 | 884 | (7) |
| Legislature, Judicial, Const. Officers | 514 | 528 | 14 |
| State Agencies' Operations & Grants | 1,832 | 1,835 | 3 |
| Debt Service | 571 | 545 | (26) |
| Capital Projects | 501 | 901 | 400 |
| Estimated Cancellations | (21) | (16) | 5 |
| Subtotal-Major Spending Categories | 21,251 | 21,366 | 115 |
| Dedicated Expenditures | 294 | 283 | (11) |
| Total Expenditures & Transfers | \$21,545 | \$21,649 | \$104 |

Significant caseload and enrollment savings in K-12 education, health care, income support, and other decreases are offset by the statutory allocation of \$400 million to convert state bond authorizations to general fund cash financing. Aside from these major changes, the remaining forecast changes largely reflect normal movement of expenditures, such as transfers between agencies.

FY 2000-01 Biennial Budget Expenditure Estimates

Projected state general fund expenditures for FY 2000-01 total \$22.596 billion, a 4.4 percent increase over the current forecast for FY 1998-99 spending. However, spending totals for the current biennium contain two significant one-time items: \$109 million for the remaining portion of the school property tax recognition shift, and \$901 million in general fund cash

financed capital projects. After removing these items, the FY 2000-01 forecast of ongoing expenditures increases 9.5 percent over FY 1998-99.

FY 2000-01 Expenditure Estimates

| | (\$ in millions) | | | |
|---|------------------------|------------------------|-----------|----------|
| | FY 1998-99 Biennium | FY 2000-01 Biennium | \$ Change | % Change |
| <u>Estimated Spending by Function</u> | | | | |
| Education/Children & Families | \$6,912 | \$7,609 | \$697 | 10.1% |
| Property Tax Recognition | 109 | 0 | (109) | na |
| Post-Secondary Education | 2,444 | 2,466 | 22 | 0.9% |
| Property Tax Aids & Credits | 2,576 | 3,173 | 597 | 23.2% |
| Other Major Local Assistance | 1,011 | 1,134 | 123 | 12.1% |
| Health Care | 3,120 | 3,776 | 656 | 21.1% |
| Family Support | 517 | 519 | 2 | 0.4% |
| State Operated Institutions | 884 | 967 | 83 | 9.4% |
| Legislature, Judicial, Const. | 528 | 532 | 4 | 0.9% |
| State Agencies Operations & Grants | 1,835 | 1,682 | (153) | (8.4%) |
| Debt Service and Other | 545 | 536 | (9) | (1.8%) |
| Capital Projects | 901 | 0 | (901) | na |
| Estimated Cancellations | (16) | (20) | (4) | 27.9% |
| Subtotal- Major Spending | 21,366 | 22,374 | 1,008 | 4.7% |
| Dedicated Expenditures | 283 | 221 | (62) | (21.8%) |
| Total Expenditures & Transfers | \$21,649 | \$22,596 | \$947 | 4.4% |

Major growth areas in state spending for FY 2000-01 over the current biennium continue to be K-12 education, property tax aids and credits programs, and health care. State agency costs are actually projected to fall in FY 2000-01 due to the large number of one-time appropriations in the previous biennium. Changes in forecast variables and the conversion of bonds to cash also result in a reduced debt service estimate.

These expenditure projections include a 2.5 percent annual across-the-board inflation increase for budget planning purposes. While funding projected inflation is not required, the adjustment reflects the impact of expected price increases on the aggregate cost of government operations. The total inflation included in the FY 2000-01 estimates is \$799 million.

FY 2002-03 Expenditure Planning Estimates

The 2002-03 planning estimates project expenditures beyond the upcoming budget biennium. These outyear estimates provide a baseline from which to measure the affordability of longer term policy choices that might be considered in the 1999 legislative session.

FY 2002-03 Expenditure Planning Estimates

(\$ in millions)

| | FY 2000-01 Biennium | FY 2002-03 Biennium | \$ Change | % Change |
|---|------------------------|------------------------|----------------|-------------|
| <u>Estimated Spending by Function</u> | | | | |
| Education/Children & Families | \$7,609 | \$7,936 | \$327 | 4.3% |
| Post-Secondary Education | 2,466 | 2,613 | 147 | 6.0% |
| Property Tax Aids & Credits | 3,173 | 3,496 | 323 | 10.2% |
| Other Major Local Assistance | 1,134 | 1,224 | 90 | 7.9% |
| Health Care | 3,776 | 4,567 | 791 | 20.9% |
| Family Support | 519 | 562 | 43 | 8.3% |
| State Operated Institutions | 967 | 1,034 | 67 | 6.9% |
| Legislature, Judicial, Const. | 532 | 555 | 23 | 4.3% |
| State Agencies Operations & Grants | 1,682 | 1,759 | 77 | 4.6% |
| Debt Service and Other | 536 | 561 | 25 | 4.7% |
| Estimated Cancellations | (20) | (20) | 0 | 0.0% |
| Subtotal- Major Spending | 22,374 | 24,287 | 1,914 | 8.6% |
| Dedicated Expenditures | 221 | 221 | 0 | 0.0% |
| Total Expenditures & Transfers | \$22,596 | \$24,508 | \$1,914 | 8.5% |

All FY 2002-03 expenditure projections begin with the forecast level of spending for FY 1999. Like the estimates for the budget biennium, these projections are based on current law, incorporating forecast caseload and enrollment changes and an additional 2.5 percent each year for estimated inflation.

Lower Forecast Enrollment Reduces K-12 Education Finance Costs in FY 1998-99

FY 1998-99 spending for K-12 education is projected to decrease by \$39 million since the end of session, to \$6.912 billion for the biennium. Reported enrollment for the 1997-98 school year has dropped by 2,100 students since February, bringing the state's estimated enrollment to 844,515 for that school year. The downward trend carries through to the next two biennia. After a decade of increasing K-12 enrollment, the state is projected to see an actual decrease in the number of students by the 2000-01 school year (FY 2001).

The enrollment drop is largely responsible for the \$17 million savings in the pupil-driven general education program. Enrollment changes are directly responsible for a total of \$26 million in savings, which are offset by several other changes totaling \$9 million.

Categorical programs contribute the other \$22 million in savings. Projected spending on special education programs has decreased by \$11 million since end of session estimates, continuing the recent trend of slower growth in these programs. The remaining \$11 million decrease reflects the net amount of many smaller changes in K-12 and early childhood spending and the realignment of administrative funds.

K-12 Costs Projected to Grow 10 percent Next Biennium

Spending in K-12 education is projected to grow to \$7.609 billion in FY 2000-01, an increase of \$697 million over FY 1998-99. This total includes \$420 million of program growth under current law and \$277 million in discretionary inflation.

The increase reflects the net effect of a series of significant changes in both education and tax law over the last several years. These changes are most evident in the general education program, which is projected to increase by \$319 million in FY 2000-01, before inflation. Property tax reform enacted by the 1997 and 1998 legislatures contributes the largest share, \$192 million, of the increase. These funds, combined with the \$601 million education homestead credit, are projected to increase the state share of education funding from 61% in FY 1998 to 67% in FY 2002.

Other major changes in the general education program from F.Y 1998-99 to FY 2000-01 include:

- \$75 million more due to the \$79 increase in the formula allowance from FY 1998 to FY 1999
- \$27 million more due to higher biennial enrollment in FY 2000-01 compared with FY 1998-99, even though enrollment begins to fall off in 2001
- \$27 million increase in compensatory funding
- \$25 million more for referendum equalization, as a higher proportion of passing referenda are offset by greater yield on the referenda levies due to increased valuation
- \$25 million for graduation standards implementation revenue, reflecting the biennial cost of the program implemented in FY 1999
- \$68 million less in training and experience (T & E) aid, reflecting the phase-out of the program under current law
- A net decrease of \$14 million, combining the effects of several roll-ins and consolidations, including a \$64 million decrease to general education due to a 1998 levy simplification provision and a \$48 million increase due to the roll-in of the assurance of mastery and limited English proficiency programs
- Other changes which total \$30 million, bringing the general education change to \$319 million.

While general education funds provide districts with general operating funds, categorical aid provides districts with funds targeted to specific district needs. State aid for the categorical programs is projected to grow by \$100 million in FY 2000-01, before inflation. This reflects the net effect of several major differences between FY 1998-99 and FY 2000-01, including:

- A decrease of \$245 million in FY 2000-01, reflecting the removal of one-time FY 1998-99 programs;
- A \$263 million increase in special education programs, reflecting the state takeover of the special education program through a fold-in of school district Homestead and Agricultural Credit (HACA) and higher costs in the special education excess cost program;
- A \$58 million increase in several categorical programs due to the '98 session property tax reform provisions;
- A total of \$24 million in other miscellaneous changes, including decreases for categorical programs rolled into general education, and other phase-outs.

FY 2002-03 Education Finance Costs Driven By Inflation

In FY 2002-03, spending in elementary and secondary education is projected to increase by \$327 million, to \$7.936 billion. Discretionary inflation adds \$380 million, while other forecast changes reduce costs by \$53 million.

Under current law, general education is projected to fall by \$52 million from FY 2000-01. Falling enrollment is expected to decrease costs by \$20 million, offset by \$19 million in increased costs due to projected increases in the Limited English Proficiency (LEP) population. The continued phase-out of the T & E program accounts for an additional \$46 million decrease. Other changes net to the total decrease of \$53 million in this spending area.

While the forecast assumes a continuing state role in education funding, under current law the major portions of the state's education finance system are repealed in FY 2002. This provision was first enacted in 1992 and was originally scheduled to take effect in FY 2000, but was delayed by the 1998 Legislature until FY 2002. If the repealer were to take effect, districts would be faced with a \$1.7 billion shortfall in property taxes payable in 2001 and a loss of \$2.8 billion in state aid. This would leave the state with the decision of how and whether to replace the lost funding.

Post-Secondary Education Forecast Down \$7 million in FY 1998-99; Costs Will Rise \$22 million in FY 2000-01

Total forecast spending for post-secondary education is \$7 million below end-of-session estimates for the FY 1998-1999 biennium. The variance is due largely to a technical adjustment in the reporting of interest income MnSCU earns on its cash balances of tuition and fees.

MnSCU financial activity also affects reported state dedicated reserves; a \$34 million change in those balances is attributable to funds carried forward into FY 1999, increasing MnSCU's reserve balance to \$127 million. Of this amount, \$17 million is reserved to pay outstanding FY 1998 obligations. After adjusting for these obligations, MnSCU estimates that about \$43 million of its cash balance is reserves for which no use is currently planned; \$6 million of this amount is held centrally and \$37 million at the campuses. MnSCU Board of Trustees policy directs each college and university to maintain a reserve of between 5% and 7% of its prior year operating budget. System wide, campus reserves averaged 4.8% of FY 1998 operating revenues.

Spending reductions for one-time appropriations to the University of Minnesota and MnSCU and lower-than-forecast enrollments restrict the growth in post-secondary education spending in the FY 2000-2001 biennium. Total higher education spending is projected to rise by \$22 million, a change of only 1% from FY 1998-1999. The University and MnSCU will each make a one-time pay back of funds received for projected enrollment increases in the current biennium that were not realized. In addition, MnSCU's ongoing appropriations in the next biennium are reduced for an enrollment decline forecast in FY 1999. MnSCU will receive additional funds for expected enrollment increases of 3% in the first year and 6% in the second year of the next biennium, but these increases do not fully offset the other reductions, leaving MnSCU's budget for FY 2000-2001 at \$3 million below FY 1998-1999.

Property Tax Aids & Credits Forecast Falls \$24 million for Current Biennium

Property tax aids and credits expenditures for the 1998-99 biennium are expected to decline by \$24 million from end-of-session estimates. Most of the change is accounted for in four programs; declines in Property Tax Refunds, Aid to Police and Fire, and Local Government Aid (LGA) amount to \$26 million. These declines are offset by a slight increase in the Education Homestead Credit of \$2 million.

Aids & Credits Forecast Rises \$597 million for 2000-2001 Biennium

Property tax aids and credits expenditures for the 2000-01 biennium are expected to increase by \$597 million (23 percent). Of this total, \$117 million is attributable to forecast discretionary inflation that is not specifically tied to an individual program. Much of the remaining biennial growth in expenditures, \$472 million, is due to property tax reform efforts in 1998. Significant increases are expected in Property Tax Refunds, Local Government Aid, Family Preservation Aid and the Education Homestead Credit. These increases are offset by the continued shift of Homestead and Agricultural Credit Aid (HACA) to special education.

The Education Homestead Credit is forecast to grow by \$457 million. Part of the growth can be attributed to the fact that the credit only existed for one fiscal year during the 1998-99 biennium. The remainder of the increase is due to 1998 property tax reform that increased the credit from 32% of the school portion of homeowners' property taxes to 66.2% by FY 2000.

HACA is projected to decline by \$78 million mainly because of a continued transfer of school district HACA to fund state aid for special education. The 1998 transfer of \$10 million in county HACA to fund an increase in Family Preservation Aid in FY 2001 was offset by an additional \$13 million for fiscal disparities HACA.

Local Government Aid is expected to grow by \$38 million, primarily due to \$28 million in statutory formula inflation adjustments and a \$12 million appropriation from 1998 property tax reform, reduced by Tax Increment Financing (TIF) aid reductions of \$2 million.

Property Tax Refunds are expected to increase by \$30 million. Renter refunds increase \$44 million because of rent increases and a 1998 law change increasing presumed property tax amounts from 18 percent to 19 percent of rent. Homeowner refunds offset this increase by \$12 million due to 1998 property tax reforms. Targeting refunds also declined by \$1 million because of lower expectations for market value growth.

Family Preservation Aid will increase \$30 million due to 1998 legislative actions, including a \$10 million transfer of county HACA.

Aids & Credits Forecast Rises \$323 million for 2002-2003 Biennium

Expenditures for local aids and credits for the 2002-03 biennium are expected to increase by \$323 million over FY 2000-01 forecast levels. Of this amount, \$175 million is forecast additional discretionary inflation adjustments. The remaining \$148 million increase is due to statutory inflation in the formulas used to determine the aids and credits. Property tax refunds increase by \$38 million because of expected increases in property tax levies, market values of homes, and apartment rents. Statutorily applied inflation causes Local Government Aid increase by \$32 million. Aid to Police & Fire grows by \$15 million due to forecast growth in the insurance premiums taxes. 1998 legislative session property tax reform changes cause the \$32 million increase in Family Preservation Aid. The Education Homestead credit is expected to increase by \$58 million as a result of increases in market values and numbers of homesteads. The only major decline, \$31 million, occurs in HACA as the transfer of school district HACA to state aid for special education continues.

Other Major Local Assistance to Increase \$122 million in FY 2000-01

Other major local assistance spending is projected to increase \$122 million in the next biennium, a 12.1 percent increase over FY 1998-99. This amount includes \$41 million in discretionary inflation. Several factors account for the change.

Human services grant programs increase by \$48 million, almost half of which is accounted for by discretionary inflation. Increased costs occur primarily in the Group Residential Housing program and miscellaneous other grant programs.

The Ethanol Development subsidy is forecast to grow by \$16 million or almost 33 percent. Crime Victim Services Center spending totals show an increase of \$45 million; this is not a real cost increase but merely reflects the transfer of various grant programs from other state agencies.

1998-99 Health Care Forecast Declines by \$173 Million

Health care costs are forecast to decline by \$173 million in the current biennium, to a total of \$3.120 billion. Strong economic conditions have lowered projected caseloads, resulting in savings of \$156 million from end-of-session estimates. General Assistance Medical Care (GAMC) costs are \$21 million lower during the same period. Other health care expenditures are expected to increase by \$4 million.

The \$156 million savings in forecast Medical Assistance (MA) expenditures represents a five percent decline from end-of-session projections. Savings are distributed between Long Term Care Facilities (\$66 million), Waiver Programs (\$18 million), Elderly & Disabled Basic Care (\$26 million), and MFIP & Families Basic Care (\$46 million).

Savings in Long Term Care Facilities costs are due to lower overall nursing facility caseload. The number of MA recipients in FY 1998 was nearly 900 persons lower than previously expected, representing a three percent decline from previously forecast levels.

Lower costs in the MFIP & Families Basic Care health care programs are also due to reduced caseload estimates. MFIP enrollment has declined significantly from end-of-session estimates and is responsible for most of these health care savings. Average monthly enrollment for FY 1998 is nearly 14,000 (5 percent) persons lower than expected.

FY 2000-01 Health Care Costs to Increase by \$657 Million

In FY 2000-01, health care costs are forecast to increase by \$657 million (21.1 percent) from the current biennium, to a total of \$3.776 billion. This increase is composed of a \$483 million increase in MA, a \$26 million increase in GAMC, a \$9 million increase in other programs, and a \$139 million increase for discretionary inflation. Total health care spending for the FY 2000-01 biennium is \$255 million (six percent) lower than had been estimated at the end of the 1998 session.

The \$483 million increase in MA expenditures for FY 2000-01 is split between four service segments. Much of the increase is due to projected spending for disabled and elderly persons.

Medical Assistance: FY 2000-01 Cost Increases

(\$ in millions)

| MA Segment | \$ Change | % Change |
|-------------------------------|------------------|-----------------|
| Long Term Care Facilities | \$33 | 3.1% |
| Waivered Programs | 191 | 36.4% |
| Elderly & Disabled Basic Care | 203 | 31.3% |
| MFIP & Family Basic Care | 57 | 10.4% |
| Total | \$483 | 17.4% |

Spending growth follows projected MA enrollment changes. The expected enrollment in FY 2000-01 for elderly persons grows by 11.0 percent and disabled or blind enrollment grows by 7.6 percent. On the other hand, MA enrollment for MFIP recipients drops by 4.7 percent and enrollment for other families with children drops by 6.8 percent.

Another element of the projected health care cost growth is increasing cost for services. Managed care rates are rising for all health care purchasers and are expected to increase state costs by an additional 4 to 8 percent in MA and GAMC. Average payments for MFIP & Families Basic Care are projected to be \$201 per enrollee month in FY 2001, up 6.9 percent from FY 1999. Average payments for Elderly & Disabled Basic Care are projected to be \$581.07 per enrollee month in FY 2001, up 15.4% from FY 1999.

General Assistance Medical Care costs are expected to grow by \$26 million, to a total of \$290 million. The change is the net effect of a decreased caseload with lower cost eligibles moving onto the MinnesotaCare program and an increasing service cost. Average GAMC cost is forecast to rise 26 percent from \$420 per month to \$531 per month due to medical inflation and a significantly more expensive case mix.

The remaining \$9 million increase is due to forecast growth in the Chemical Dependency entitlement and annualized cost growth in the new Senior Drug Program.

FY 2002-03 Health Care Costs Estimated to Increase by \$791 Million

FY 2002-03 health care costs are forecast to increase by \$791 million (20.9 percent) over the prior biennium, to a total of \$4.567 billion. Biennial increases are split between Medical Assistance (\$511 million), General Assistance Medical Care (\$29 million), Other Health Care (\$9 million) and additional discretionary inflation (\$242 million).

The projected expenditures continue trends set in the prior biennium. Enrollment growth continues for elderly and disabled populations, creating increased pressure on long term care services and basic care. Average cost growth also trends forward, leading to significant increases in overall spending.

Family Support Costs Down \$20 million in Current Biennium

Family Support spending is expected to be \$20 million lower for the current biennium than end-of-session estimates. This includes \$17 million in child care savings, \$7 million in General Assistance and MN Supplemental Aid savings, and \$4 million in higher MFIP spending.

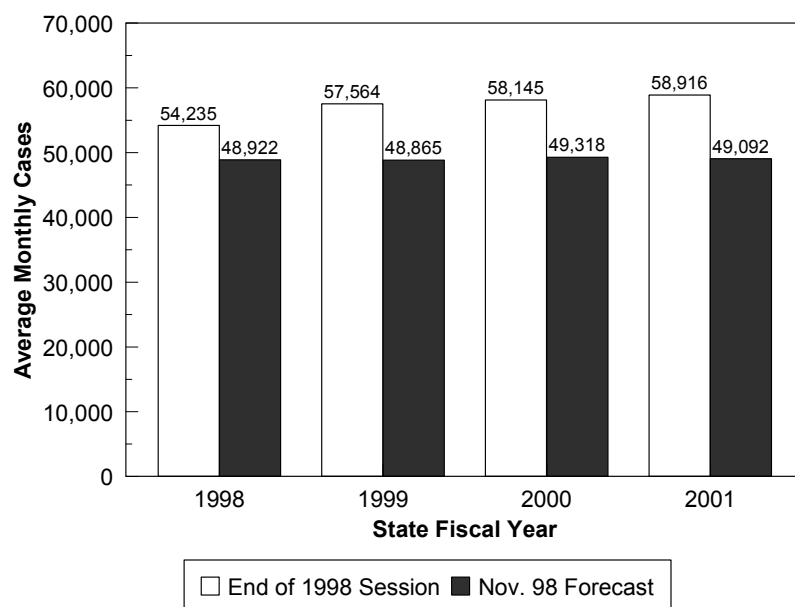
The forecast for Child Care programs, including MFIP Child Care, Basic Sliding Fee, and child care development, is down \$17 million in FY 1998-99 from end-of-session projections.

This is largely due to lower spending in the Transition Year component of the MFIP Child Care program, which is available to families who have recently moved off the MFIP cash assistance program.

The strong state economy contributed to a continued drop in MFIP and GA caseloads, with MFIP caseloads approximately 10 percent lower in FY 1998 and 15 percent lower in FY 1999 and less significant declines in the GA estimates.

As MFIP caseloads have fallen, child support collections have also fallen. Because these collections offset the state's costs for MFIP, this decline means an additional \$5 million will be needed in FY 1999.

MFIP Caseload Estimates



MFIP and MFIP Child Care spending are key elements of meeting maintenance of effort (MOE) provisions for the federal Temporary Assistance to Needy Families (TANF) block grant. Minnesota meets its annual \$192 million MOE requirement through eligible spending in four categories; cash assistance, child care subsidies, administration, and employment services. As a result, even when welfare caseloads fall significantly, the savings that can be realized by the General Fund are limited by the MOE requirement.

The inability to capture General Fund savings translates into more unspent federal block grant dollars. These dollars are held in a federal TANF Reserve. The lower expenditures in this forecast mean that the TANF Reserve will accumulate \$86 million more than was previously projected for FY 1998-99.

FY 2000-01 Family Support Spending Shifts Between Programs

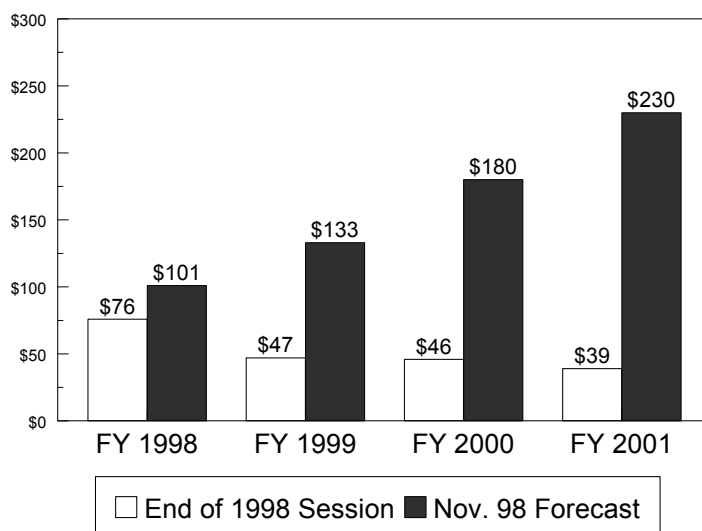
Forecast family support spending for FY 2000-01 will be \$2 million higher than FY 1998-99. The increase is the net of \$17 million in lower program spending and \$19 million in discretionary inflation.

State child care spending is projected to increase by \$105 million over the FY 1998-99 biennium, to a total of \$290 million before inflation. Although overall MFIP caseloads are down, caseloads for working, single-parent families are projected to rise. These families use child care subsidies at a higher rate than any other segment of the MFIP caseload.

Even as forecast child care expenditures are increasing, MFIP cash assistance spending is expected to decrease by \$75 million in FY 2000-01. State spending on MFIP cash assistance and child care for MFIP recipients both meet the federal MOE requirements. As a result, the shift in state spending from MFIP cash assistance to child care does not jeopardize the state's receipt of the full amount of the TANF block grant.

TANF reserves continue to increase for FY 2000-01. In each fiscal year between FY 1998 and FY 2003, the state comes far short of using its entire \$268 million TANF block grant (FY 1999 represents the highest proportion, at 88 percent). The result is a growing balance of unobligated TANF funds. At the end of FY 2001, projections are that the federal TANF Reserve will equal \$230 million, up from end-of-session projections of \$39 million.

Federal TANF Reserve Balances
(\$ in millions)



General Assistance and MN Supplemental Aid are expected to decrease by \$47 million; virtually all of this change is due to the transfer of payments for Battered Women's Shelters from the GA program to Crime Victim Services.

FY 2002-03 Family Support Planning Estimates Up \$43 million

Family support spending for FY 2002-03 is projected to be \$43 million higher than in FY 2000-01. The increase is composed of a \$15 million increase in program spending and \$28 million in discretionary inflation.

State child care spending is expected to be \$334 million for the FY 2002-03 biennium, an increase of \$33 million (including inflation) from FY 2000-01. A significant part of the increase is for Transition Year child care assistance. There is little change in the forecast level of spending for economic support programs.

FY 2003 will mark the first point at which MFIP recipients will face discontinuation of benefits due to federal time limits. Federal welfare reform limited the receipt of federally-funded benefits to 60 months in an individual's lifetime. Federal law allows states to define exceptions to the time limits for 20 percent of the caseload; federal TANF funds may be spent on these cases. At the beginning of FY 2003, approximately 16 percent of the MFIP caseload will lose eligibility for such benefits, rising to approximately 24 percent by the end of FY 2003. The FY 2003 planning estimate predicts an average 20 percent decline in the MFIP caseload due to these requirements, with substantial savings in TANF spending.

State Institutions' Costs Projected to Rise \$83 million in FY 2000-01, \$67 million in FY 2002-03

The cost of operating state institutions (residential treatment centers, prisons, Faribault Academies, the Arts School and veteran's homes) is expected to increase \$83 million under FY 2000-01 planning estimates. Discretionary inflation accounts for \$35 million of this amount.

Operating and expanding the state's prison system to accommodate growing numbers of inmates continues to be the major factor in the growth of spending on state institutions. The FY 2000-01 planning estimates project that the cost of state correctional facilities will grow by \$61 million over the current biennium. In addition to inflation of \$17 million, the FY 2000-01 planning estimates include \$35 million for start-up and operational costs of the new adult male prison at Rush City, set to open in early 2000, and \$9 million for housing additional inmates at other existing correctional facilities in the state. These estimates are based on preliminary projections by the Department of Corrections of inmate populations in the FY 2000-01 biennium and of the cost for housing the additional prisoners during that time.

State residential facilities operated by the Department of Human Services are the second largest source of growth for state institutions. State residential facilities are forecast to grow by \$17 million in FY 2000-01, the majority of which is for inflation.

FY 2002-03 planning estimates for state institutions show net growth of \$67 million over FY 2000-01 forecast levels. The most significant factors in this growth are inflation of \$51 million, and caseload increases in state correctional institutions estimated to cost \$20 million. Preliminary projections by the Department of Corrections estimate the number of adult inmates at nearly 7,000 by the end of FY 2003, about 1,400 more than the current count. Minor forecast changes account for the remaining net difference.

State Agencies' Costs Forecast to Drop \$153 million for FY 2000-01

The FY 2000-01 forecast for state agency operations and grant programs falls \$153 million, over 8 percent from the forecast for the current biennium. This decline is on top of \$60 million in projected discretionary inflation increases. The reduction is primarily due to an unusually large number of one-time appropriations made to state agencies during the current biennium. Major non-recurring items in individual departments include:

- \$13 million in Agriculture, including \$4 million for tornado relief and \$9 million for federal crop insurance relief
- \$38 million in Trade and Economic Development, including \$6 million for tornado relief, \$7 million for flood relief, \$7 million in wastewater treatment facility loans, and \$19 million in other miscellaneous programs
- \$24 million in Public Safety, including \$9 million for tornado relief and approximately \$13 million in one-time community assistance grants to address gang and other crime problems
- \$36 million in Administration, including \$27 million for Year 2000 computer system modifications and \$5 million for building repair
- \$17 million in Veteran's Affairs for the Persian Gulf War Veteran's bonus

Current Biennium Debt Service Estimates are \$26 Million Lower

The total estimated debt service required for the 1998-99 biennium is now \$545 million. This includes a \$17 million cost attributable to cash payments necessary to satisfy the Cambridge bank judgment.

The current estimate is \$26 million lower than the end-of-session estimates. More than \$15 million was saved due to bond premiums paid and accrued interest from the June and November 1998 bond sales. Other differences result from higher investment earnings on cash balances in the debt service fund and the building fund, higher receipts from user fees, and selling fewer bonds than originally forecast.

FY 2000-01 Debt Service Savings Reflect Fewer Planned Bond Sales

Before the conversion of \$400 million of 1998 bond authorizations to general fund cash financing, the net debt service estimate for the 2000-01 biennium is \$588 million. After the conversion of bond authorizations to cash, the net debt service estimate for the 2000-01 biennium is \$535 million. The conversion results in a debt service savings of \$53 million. The difference is due to the need to sell fewer bonds, holding three bond sales instead of five sales, the structuring of the bonds and lower forecast interest rates. The \$535 million estimate is \$10 million lower than the forecast for the current biennium.

The \$535 million is the amount needed during the 2000-01 biennium to meet the constitutional requirements for the debt service transfer from the general fund to the debt service fund on outstanding general obligation bonds, additional bond sales for currently authorized projects, and to fund future capital budgets. To be consistent with estimates made in the 1998 session, for planning purposes the forecast assumes capital budgets of \$50 million in the 1999 legislative session and \$700 million in the 2000 session.

2002-03 Debt Service Planning Estimates

The forecast net debt service for the 2002-03 biennium is \$561 million. This is an increase of \$26 million from the 2000-01 biennium. Total bonds sold during the biennium is estimated at \$736 million, up from \$401 million in the 2000-01 biennium. This results in an increase in the amount of debt service required during the 2002-03 biennium for the new bonds sold. Forecast interest rates are also slightly higher in the 2002-03 biennium resulting in higher interest costs.

The dollar amount of bonds sold during the 2002-03 biennium increases over the previous biennium because of the one time conversion of the 1998 bond authorization to general fund cash. This conversion results in the need to sell fewer bonds in the 2000-01 biennium, while bond sales are assumed to rise to a more “normal” level in 2002-03.

Selected Statutory Provisions

Minnesota Statutes, 1998

Chapter 16A.103 Forecasts of revenue and expenditures.

Subdivision 1. **State revenue and expenditures.** In February and November each year, the commissioner shall prepare a forecast of state revenue and expenditures. The November forecast must be delivered to the legislature and governor no later than the end of the first week of December. The February forecast must be delivered to the legislature and governor by the end of February. The forecast must assume the continuation of current laws and reasonable estimates of projected growth in the national and state economies and affected populations. Revenue must be estimated for all sources provided for in current law. Expenditures must be estimated for all obligations imposed by law and those projected to occur as a result of inflation and variables outside the control of the legislature. In determining the rate of inflation, the application of inflation, and the other variables to be included in the expenditure part of the forecast, the commissioner must consult with the chair of the senate state government finance committee, the chair of the house committee on ways and means, and house and senate fiscal staff. In addition, the commissioner shall forecast Minnesota personal income for each of the years covered by the forecast and include these estimates in the forecast documents. A forecast prepared during the first fiscal year of a biennium must cover that biennium and the next biennium. A forecast prepared during the second fiscal year of a biennium must cover that biennium and the next two bienniums.

Minnesota Statutes 1998

Chapter 16A.152 Budget reserve and cash flow account

Subdivision 2. [PRIORITIES.] If on the basis of a forecast of general fund revenues and expenditures after November 1 in 1998, the commissioner of finance determines that there will be a positive unrestricted budgetary general fund balance at the close of the biennium, the commissioner of finance must allocate money as follows:

- ◆ first, to the budget reserve until the total amount in that account equals \$622,000,000; then;
- ◆ second, to the tax reduction and reform account until the amount allocated equals \$200,000,000; and;

third, to reduce the need to borrow money to finance state building projects as provided in subdivision 3 until the amount allocated equals \$400,000,000.

ALTERNATIVE FORECAST COMPARISON

Real GDP (Annual Rates)

| | <u>98II</u> | <u>98III</u> | <u>98IV</u> | <u>99I</u> | <u>99II</u> | <u>99III</u> | <u>97A</u> | <u>98A</u> | <u>99A</u> | <u>00A</u> |
|-----------------------------------|-------------|--------------|-------------|------------|-------------|--------------|------------|------------|------------|------------|
| DRI Control (11-98) | 1.8 | 3.3 | 2.2 | 0.9 | 1.1 | 2.2 | 3.9 | 3.6 | 1.7 | 2.3 |
| Georgia State (11-98) | 1.8 | 4.5 | 3.3 | 1.8 | 2.0 | 2.3 | 3.9 | 3.8 | 2.6 | 2.5 |
| Blue Chip (11-98) | 1.8 | 3.3 | 2.1 | 1.7 | 1.9 | 2.2 | 3.9 | 3.5 | 2.1 | NA |
| American Express (IDS) (11-98) | 1.8 | 3.3 | 3.6 | 2.5 | 2.6 | 2.7 | 3.8* | 3.5* | 2.7* | NA |
| Merrill-Lynch (11-98) | 1.8 | 3.3 | 2.2 | 1.1 | 1.2 | 1.5 | 3.9 | 3.6 | 1.7 | 2.8 |

* 4Q/4Q

GDP Deflator (Chain-Weighted, Annual Rates)

| | <u>98II</u> | <u>98III</u> | <u>98IV</u> | <u>99I</u> | <u>99II</u> | <u>99III</u> | <u>97A</u> | <u>98A</u> | <u>99A</u> | <u>00A</u> |
|-----------------------------------|-------------|--------------|-------------|------------|-------------|--------------|------------|------------|------------|------------|
| DRI Control (11-98) | 0.9 | 0.8 | 1.4 | 1.9 | 1.9 | 1.9 | 1.9 | 1.0 | 1.6 | 2.0 |
| Georgia State (11-98) | 0.9 | 0.5 | 0.7 | 1.1 | 1.1 | 1.1 | 1.9 | 0.9 | 0.9 | 1.2 |
| Blue Chip (11-98) | 0.9 | 0.8 | 1.4 | 1.7 | 1.8 | 1.8 | 1.9 | 1.1 | 1.6 | NA |
| American Express (IDS) (11-98) | 0.9 | 0.8 | 1.5 | 2.4 | 2.3 | 2.2 | 1.7* | 1.0* | 2.3* | NA |
| Merrill-Lynch (11-98) | 0.9 | 0.8 | 0.7 | 1.1 | 0.7 | 0.7 | 1.9 | 1.0 | 0.8 | 1.0 |

* 4Q/4Q

FORECAST COMPARISONS

Real Economic Growth (Annual Percent Change in Real GDP)

| | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|--------------------|-------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Nov 94 DRI Control | 3.0 | 1.8 ⁽¹⁾ | 1.8 ⁽¹⁾ | 1.8 ⁽¹⁾ | 1.8 ⁽¹⁾ | |
| Feb 95 DRI Control | 3.0 | 1.7 ⁽¹⁾ | 1.7 ⁽¹⁾ | 1.7 ⁽¹⁾ | 1.7 ⁽¹⁾ | |
| Nov 95 DRI Control | 2.8 | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | |
| Feb 96 DRI Control | 2.8 | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | 1.7 ⁽²⁾ | |
| Nov 96 DRI Control | 2.4 | 2.4 | 2.0 | 1.6 ⁽³⁾ | 1.6 ⁽³⁾ | |
| Feb 97 DRI Control | 2.9 | 2.1 | 2.1 | 1.6 ⁽³⁾ | 1.6 ⁽³⁾ | |
| Nov 97 DRI Control | 3.8 | 2.3 | 2.0 | 2.5 | 1.7 ⁽⁴⁾ | |
| Feb 98 DRI Control | 3.8 | 2.7 | 1.4 | 2.4 | 1.7 ⁽⁴⁾ | |
| Nov 98 DRI Control | 3.9 | 3.6 | 1.7 | 2.3 | 2.1 | 1.7 ⁽⁵⁾ |

Inflation

(Annual Percent Change in Implicit GDP Deflator - 1992 = 100)

| | | | | | | |
|--------------------|-----|--------------------|--------------------|--------------------|--------------------|-----|
| Nov 94 DRI Control | 2.8 | 3.7 ⁽³⁾ | 3.7 ⁽³⁾ | 3.7 ⁽³⁾ | 3.7 ⁽³⁾ | |
| Feb 95 DRI Control | 2.3 | 3.2 ⁽³⁾ | 3.2 ⁽³⁾ | 3.2 ⁽³⁾ | 3.2 ⁽³⁾ | |
| Nov 95 DRI Control | 1.9 | 2.1 ⁽⁴⁾ | 2.4 ⁽⁴⁾ | 2.1 ⁽⁴⁾ | 2.4 ⁽⁴⁾ | |
| Feb 96 DRI Control | 1.7 | 2.1 ⁽⁶⁾ | 2.4 ⁽⁶⁾ | 2.1 ⁽⁶⁾ | 2.4 ⁽⁶⁾ | |
| Nov 96 DRI Control | 2.4 | 2.3 | 2.4 | 2.6 | 2.8 | |
| Feb 97 DRI Control | 1.9 | 2.3 | 2.5 | 2.7 | 2.9 | |
| Nov 97 DRI Control | 2.1 | 2.0 | 2.1 | 2.3 | 2.3 | |
| Feb 98 DRI Control | 2.0 | 1.7 | 1.9 | 2.2 | 2.1 | |
| Nov 98 DRI Control | 1.9 | 1.0 | 1.6 | 2.0 | 2.1 | 2.3 |

(1) Long-term trend from DRI Cyclelong, Summer 1994 and Winter 1994/95.

(2) Long-term trend from DRI Cyclelong, Summer 1995.

(3) Long-term trend from DRI Cyclelong, Summer 1996.

(4) Long-term trend from DRI Cyclelong, Summer 1997.

(5) Long-term trend from DRI Cyclelong, Summer 1998.

(6) Summer 1994 Trendlong Forecast.

MINNESOTA - U.S. COMPARISON REPORT

Annual Percent Changes

November 1998 Control

| | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Wage and Salary Income | | | | | | | | |
| United States | 4.9 | 5.8 | 5.9 | 7.1 | 6.6 | 5.4 | 4.9 | 4.5 |
| Minnesota | 5.8 | 6.5 | 7.6 | 7.4 | 6.6 | 5.1 | 5.4 | 4.8 |
| Implied Annual Wage | | | | | | | | |
| United States | 1.8 | 3.1 | 3.7 | 4.4 | 4.0 | 4.0 | 3.7 | 3.3 |
| Minnesota | 2.7 | 3.5 | 5.2 | 5.2 | 4.0 | 3.6 | 3.9 | 3.7 |
| Non-Farm Employment | | | | | | | | |
| United States | 3.1 | 2.6 | 2.1 | 2.6 | 2.5 | 1.3 | 1.2 | 1.2 |
| Minnesota | 3.0 | 2.9 | 2.3 | 2.1 | 2.5 | 1.4 | 1.4 | 1.1 |
| Personal Income | | | | | | | | |
| United States | 5.1 | 5.5 | 5.8 | 5.6 | 4.9 | 4.3 | 4.3 | 4.4 |
| Minnesota | 7.0 | 6.0 | 7.6 | 5.8 | 5.0 | 4.2 | 4.6 | 4.3 |

Comparison of Actual and Estimated Non-Restricted Revenues (\$ in thousands)

| | 1998 Fiscal Year | | | July - Oct. 1998 | | |
|------------------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|
| | Forecast <u>Revenues</u> | Actual <u>Revenues</u> | Variance <u>Act-Fcst</u> | Forecast <u>Revenues</u> | Actual <u>Revenues</u> | Variance <u>Act-Fcst</u> |
| Four Major Revenues: | | | | | | |
| Individual Income Tax | | | | | | |
| Withholding | 4,166,327 | 4,170,006 | 3,681 | 1,396,503 | 1,415,913 | 19,410 |
| Declarations | 903,712 | 933,551 | 29,838 | 201,900 | 217,487 | 15,587 |
| Miscellaneous | 516,271 | 499,666 | (16,605) | 56,958 | 59,405 | 2,447 |
| Gross | 5,586,310 | 5,603,224 | 16,914 | 1,655,361 | 1,692,805 | 37,444 |
| Refunds | 1,061,500 | 856,654 | (204,846) | 43,576 | 36,726 | (6,850) |
| Net | 4,524,810 | 4,746,569 | 221,759 | 1,611,785 | 1,656,079 | 44,294 |
| Corporate & Bank Excise | | | | | | |
| Declarations | 781,383 | 743,025 | (38,358) | 216,000 | 214,769 | (1,231) |
| Miscellaneous | 90,520 | 101,616 | 11,096 | 30,686 | 27,486 | (3,200) |
| Gross | 871,903 | 844,642 | (27,261) | 246,686 | 242,254 | (4,432) |
| Refunds | 89,600 | 92,581 | 2,981 | 13,000 | 19,927 | 6,927 |
| Net | 782,303 | 752,061 | (30,242) | 233,686 | 222,328 | (11,358) |
| Sales Tax | | | | | | |
| Gross | 3,348,688 | 3,378,905 | 30,217 | 1,097,882 | 1,120,807 | 22,926 |
| Refunds | 133,000 | 127,221 | (5,779) | 44,000 | 49,143 | 5,143 |
| Net | 3,215,688 | 3,251,684 | 35,996 | 1,053,882 | 1,071,664 | 17,783 |
| Motor Vehicle Excise | 417,800 | 444,976 | 27,176 | 140,200 | 162,983 | 22,783 |
| Other Revenues: | | | | | | |
| Inherit/Gift/Estate | 40,712 | 62,366 | 21,654 | 15,878 | 17,330 | 1,452 |
| Liquor/Wine/Beer | 56,407 | 57,455 | 1,048 | 16,005 | 16,799 | 794 |
| Cigarette & Tobacco | 174,868 | 175,854 | 986 | 51,071 | 54,524 | 3,453 |
| Deed and Mortgage | 105,900 | 120,212 | 14,312 | 40,674 | 53,579 | 12,905 |
| Insurance Gross Earnings | 155,000 | 163,187 | 8,187 | 1,900 | 2,994 | 1,094 |
| Lawful Gambling | 63,231 | 64,918 | 1,687 | 17,027 | 17,991 | 964 |
| Health Care Surcharge | 118,290 | 122,367 | 4,077 | 36,670 | 37,680 | 1,010 |
| Other Taxes | 3,480 | 3,727 | 247 | 345 | 398 | 53 |
| General Fund RTC Revenues | 34,503 | 35,451 | 948 | 10,120 | 7,468 | (2,652) |
| Income Tax Reciprocity | 37,872 | 37,872 | 0 | 0 | 0 | 0 |
| Investment Income | 129,000 | 163,338 | 34,338 | 30,500 | 43,766 | 13,266 |
| Tobacco Settlement | 0 | 297 | 297 | 240,000 | 240,000 | 0 |
| Other and Unallocated | 80,012 | 86,105 | 6,093 | 24,692 | 27,570 | 2,878 |
| Other Subtotal | 999,275 | 1,093,149 | 93,784 | 484,882 | 520,100 | 35,218 |
| Other Refunds | 21,338 | 30,032 | 8,694 | 6,024 | 2,552 | (3,472) |
| Other Net | 977,937 | 1,063,116 | 85,180 | 478,858 | 502,459 | 38,690 |
| Total Gross | 11,223,976 | 11,364,895 | 140,920 | 3,625,011 | 3,738,950 | 113,939 |
| Total Refunds | 1,305,438 | 1,106,488 | (198,950) | 106,600 | 108,348 | 1,748 |
| Total Net | 9,918,538 | 10,258,407 | 339,869 | 3,518,411 | 3,630,602 | 112,192 |

FACTORS AFFECTING THE INDIVIDUAL INCOME TAX

(Dollars in Billions)

| | Calendar Year | | | | | |
|---------------------------------------|---------------|-------------|-------------|-------------|-------------|-------------|
| | <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> |
| Minnesota Non-Farm Tax Base | | | | | | |
| November 1994 Control | 91.982 | 96.902 | | | | |
| February 1995 Control | 91.190 | 96.611 | | | | |
| November 1995 Control | 94.160 | 97.766 | | | | |
| February 1996 Control | 94.170 | 97.880 | | | | |
| November 1996 Control | 95.750 | 100.570 | 105.170 | 109.960 | | |
| February 1997 Control | 96.410 | 101.500 | 106.270 | 111.140 | | |
| November 1997 Control | 100.450 | 106.250 | 111.700 | 116.240 | | |
| February 1998 Control | 100.450 | 107.250 | 113.040 | 116.960 | | |
| November 1998 Control | 100.430 | 107.490 | 113.850 | 118.500 | 123.620 | 128.830 |
| Minnesota Wage and Salary Inc- | | | | | | |
| November 1994 Control | 68.004 | 71.395 | | | | |
| February 1995 Control | 68.310 | 71.447 | | | | |
| November 1995 Control | 69.518 | 72.278 | | | | |
| February 1996 Control | 69.754 | 72.680 | | | | |
| November 1996 Control | 71.244 | 74.966 | 78.407 | 82.127 | | |
| February 1997 Control | 71.712 | 75.572 | 79.203 | 82.961 | | |
| November 1997 Control | 72.146 | 76.118 | 80.099 | 83.793 | | |
| February 1998 Control | 72.146 | 76.773 | 81.433 | 84.502 | | |
| November 1998 Control | 71.115 | 77.427 | 82.538 | 86.724 | 91.370 | 95.761 |
| Minnesota Property Income | | | | | | |
| November 1994 Control | 16.961 | 18.013 | | | | |
| February 1995 Control | 16.985 | 17.933 | | | | |
| November 1995 Control | 17.408 | 17.994 | | | | |
| February 1996 Control | 17.077 | 17.604 | | | | |
| November 1996 Control | 17.084 | 17.987 | 18.925 | 19.740 | | |
| February 1997 Control | 17.212 | 18.133 | 19.011 | 19.782 | | |
| November 1997 Control | 21.053 | 22.300 | 23.196 | 23.623 | | |
| February 1998 Control | 21.053 | 22.265 | 23.112 | 23.606 | | |
| November 1998 Control | 21.053 | 22.380 | 23.117 | 23.348 | 23.438 | 23.891 |
| Minnesota Proprietors' Income | | | | | | |
| November 1994 Control | 7.016 | 7.494 | | | | |
| February 1995 Control | 6.895 | 7.232 | | | | |
| November 1995 Control | 7.238 | 7.490 | | | | |
| February 1996 Control | 7.337 | 7.597 | | | | |
| November 1996 Control | 7.422 | 7.617 | 7.834 | 8.099 | | |
| February 1997 Control | 7.489 | 7.798 | 8.056 | 8.401 | | |
| November 1997 Control | 7.251 | 7.833 | 8.400 | 8.821 | | |
| February 1998 Control | 7.251 | 8.017 | 8.500 | 8.855 | | |
| November 1998 Control | 7.261 | 7.684 | 8.193 | 8.429 | 8.084 | 9.182 |

FACTORS AFFECTING SALES, CORPORATE INCOME AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

| | Fiscal Year | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| | <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> |
| SALES TAX | | | | | | |
| Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos) | | | | | | |
| November 1994 Control | 7.236 | 7.577 | | | | |
| February 1995 Control | 7.308 | 7.558 | | | | |
| November 1995 Control | 7.764 | 8.031 | | | | |
| February 1996 Control | 7.729 | 8.151 | | | | |
| November 1996 Control* | 7.758 | 8.233 | 8.601 | 8.948 | | |
| February 1997 Control | 7.758 | 8.233 | 8.705 | 9.026 | | |
| November 1997 Control | 7.802 | 8.334 | 8.911 | 9.430 | | |
| February 1998 Control | 7.767 | 8.291 | 8.802 | 9.226 | | |
| November 1998 Control | 7.911 | 8.498 | 9.182 | 9.750 | 10.207 | 10.662 |
| Minnesota's Proxy Share of U.S. Capital Equipment Spending | | | | | | |
| November 1994 Control | 7.665 | 7.702 | | | | |
| February 1995 Control | 8.029 | 7.935 | | | | |
| November 1995 Control | 8.613 | 8.763 | | | | |
| February 1996 Control | 8.679 | 8.971 | | | | |
| November 1996 Control | 8.069 | 8.757 | 9.316 | 9.900 | | |
| February 1997 Control | 8.066 | 8.777 | 9.503 | 10.154 | | |
| November 1997 Control | 7.707 | 8.511 | 9.461 | 10.148 | | |
| February 1998 Control | 7.744 | 8.518 | 9.344 | 10.038 | | |
| November 1998 Control | 7.824 | 8.555 | 9.475 | 10.338 | 10.743 | 11.224 |
| Minnesota's Proxy Share of U.S. Construction Spending | | | | | | |
| November 1994 Control | 4.813 | 4.973 | | | | |
| February 1995 Control | 4.941 | 4.974 | | | | |
| November 1995 Control | 4.830 | 5.024 | | | | |
| February 1996 Control | 4.855 | 4.916 | | | | |
| November 1996 Control | 4.966 | 5.105 | 5.243 | 5.356 | | |
| February 1997 Control | 4.966 | 5.170 | 5.290 | 5.344 | | |
| November 1997 Control | 5.015 | 5.436 | 5.752 | 6.018 | | |
| February 1998 Control | 5.027 | 5.435 | 5.810 | 6.066 | | |
| November 1998 Control | 5.051 | 5.494 | 5.983 | 6.259 | 6.620 | 6.927 |

* Reflects data revision.

FACTORS AFFECTING SALES, CORPORATE INCOME

AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

| | Fiscal Year | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| | <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> |
| SALES TAX (Cont.) | | | | | | |
| Minnesota Non-Farm Personal Income | | | | | | |
| November 1994 Control | 106.48 | 111.74 | | | | |
| February 1995 Control | 106.84 | 111.63 | | | | |
| November 1995 Control | 108.91 | 113.59 | | | | |
| February 1996 Control | 109.15 | 113.74 | | | | |
| November 1996 Control | 110.87 | 115.94 | 121.93 | 127.60 | | |
| February 1997 Control | 110.85 | 117.14 | 121.03 | 128.57 | | |
| November 1997 Control | 113.98 | 121.14 | 127.68 | 133.13 | | |
| February 1998 Control | 114.53 | 121.70 | 128.73 | 133.98 | | |
| November 1998 Control | 114.11 | 121.80 | 129.20 | 135.40 | 141.19 | 147.71 |

MOTOR VEHICLE EXCISE TAX

Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts

| | | | | | | |
|------------------------|-------|-------|-------|-------|-------|-------|
| November 1994 Control | 5.322 | 5.491 | | | | |
| February 1995 Control | 5.322 | 5.491 | | | | |
| November 1995 Control | 5.479 | 5.560 | | | | |
| February 1996 Control | 5.324 | 5.357 | | | | |
| November 1996 Control | 5.310 | 5.381 | 5.582 | 5.806 | | |
| February 1997 Control | 5.310 | 5.290 | 5.404 | 5.625 | | |
| November 1997 Control* | 5.132 | 5.123 | 5.191 | 5.339 | | |
| February 1998 Control | 5.132 | 5.128 | 5.293 | 5.392 | | |
| November 1998 Control | 5.170 | 5.249 | 5.550 | 5.575 | 5.718 | 5.900 |

CORPORATE FRANCHISE TAX

(Calendar Year)

U.S. Corporation Profits

| | | | | | | |
|------------------------|-------|-------|-------|-------|-------|-------|
| November 1994 Control | 465.3 | 491.6 | | | | |
| February 1995 Control | 460.8 | 467.7 | | | | |
| November 1995 Control | 477.4 | 476.7 | | | | |
| February 1996 Control | 472.5 | 476.6 | | | | |
| November 1996 Control* | 624.6 | 618.2 | 642.6 | 671.4 | | |
| February 1997 Control | 624.6 | 645.3 | 659.6 | 677.8 | | |
| November 1997 Control | 676.6 | 723.9 | 737.4 | 762.6 | | |
| February 1998 Control | 676.6 | 735.4 | 756.3 | 754.3 | | |
| November 1998 Control | 680.2 | 734.4 | 711.8 | 678.9 | 697.4 | 710.9 |

F.Y. 1998-99 General Fund Budget Before Allocations***November 1998 Forecast**

(\$ in Thousands)

| | Actual F.Y. 1998 | 11-98 Fcst F.Y. 1999 | 11-98 Fcst F.Y. 1998-99 |
|---|-----------------------------|---------------------------------|------------------------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,994,720 | 2,527,216 | 1,994,720 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 4,746,569 | 4,996,100 | 9,742,669 |
| Sales Tax | 3,251,685 | 3,413,654 | 6,665,339 |
| Corporate Income Tax | 752,061 | 707,400 | 1,459,461 |
| Motor Vehicle Excise | 444,976 | 435,000 | 879,976 |
| Tobacco Settlements | 297 | 460,800 | 461,097 |
| Other Non-Dedicated Revenue | 1,062,820 | 1,044,456 | 2,107,276 |
| Subtotal Net Non-Ded. Rev. | 10,258,408 | 11,057,410 | 21,315,818 |
| Dedicated Revenue | 205,815 | 139,237 | 345,052 |
| Transfers In | 254,069 | 289,954 | 544,023 |
| Prior Year Adjustments | 26,450 | 10,100 | 36,550 |
| Subtotal-Current Resources | 10,744,742 | 11,496,701 | 22,241,443 |
| Total Resources Available | 12,739,462 | 14,023,917 | 24,236,163 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 3,314,203 | 3,598,026 | 6,912,229 |
| Property Tax Recognition | 18,700 | 90,200 | 108,900 |
| Post-Secondary Education | 1,162,895 | 1,281,239 | 2,444,134 |
| Property Tax Aids & Credits | 1,216,250 | 1,359,594 | 2,575,844 |
| Other Major Local Assistance | 480,920 | 530,131 | 1,011,051 |
| Health Care | 1,509,658 | 1,609,928 | 3,119,586 |
| Family Support | 261,698 | 255,040 | 516,738 |
| State Operated Institutions | 425,412 | 458,904 | 884,316 |
| Legisl., Judicial, Const. Officers | 249,463 | 278,205 | 527,668 |
| State Agencies' Operations & Grants | 870,839 | 964,609 | 1,835,448 |
| Debt Service | 245,637 | 299,565 | 545,202 |
| Capital Projects | 300,031 | 200,659 | 500,690 |
| Estimated Cancellations | 0 | (15,643) | (15,643) |
| Subtotal-Major Spending Categories | 10,055,706 | 10,910,457 | 20,966,163 |
| Dedicated Expenditures | 156,540 | 126,782 | 283,322 |
| Total Expenditures & Transfers | 10,212,246 | 11,037,239 | 21,249,485 |
| Balance Before Reserves | 2,527,216 | 2,986,678 | 2,986,678 |
| Cash Flow Account | 350,000 | 350,000 | 350,000 |
| Budget Reserve | 513,200 | 613,200 | 613,200 |
| Property Tax Reserve Account | 550,802 | 330,181 | 330,181 |
| Tax Reform & Reduction Account | 0 | 0 | 0 |
| Dedicated Reserves | 126,801 | 131,760 | 131,760 |
| Appropriations Carried Forward | 306,405 | N/A | N/A |
| Budgetary Balance | 680,008 | 1,561,537 | 1,561,537 |

* Forecast reflects estimates before current law allocations of \$400 million to capital projects, \$200 million to the tax reform &

F.Y. 1998-99 General Fund Budget
November 1998 Forecast
(\$ in Thousands)

| | Actual F.Y. 1998 | 11-98 Fcst F.Y. 1999 | 11-98 Fcst F.Y. 1998-99 |
|---|---------------------|-------------------------|----------------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,994,720 | 2,527,216 | 1,994,720 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 4,746,569 | 4,996,100 | 9,742,669 |
| Sales Tax | 3,251,685 | 3,413,654 | 6,665,339 |
| Corporate Income Tax | 752,061 | 707,400 | 1,459,461 |
| Motor Vehicle Excise | 444,976 | 435,000 | 879,976 |
| Tobacco Settlements | 297 | 460,800 | 461,097 |
| Other Non-Dedicated Revenue | 1,062,820 | 1,044,456 | 2,107,276 |
| Subtotal Net Non-Ded. Rev. | 10,258,408 | 11,057,410 | 21,315,818 |
| Dedicated Revenue | 205,815 | 139,237 | 345,052 |
| Transfers In | 254,069 | 289,954 | 544,023 |
| Prior Year Adjustments | 26,450 | 10,100 | 36,550 |
| Subtotal-Current Resources | 10,744,742 | 11,496,701 | 22,241,443 |
| Total Resources Available | 12,739,462 | 14,023,917 | 24,236,163 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 3,314,203 | 3,598,026 | 6,912,229 |
| Property Tax Recognition | 18,700 | 90,200 | 108,900 |
| Post-Secondary Education | 1,162,895 | 1,281,239 | 2,444,134 |
| Property Tax Aids & Credits | 1,216,250 | 1,359,594 | 2,575,844 |
| Other Major Local Assistance | 480,920 | 530,131 | 1,011,051 |
| Health Care | 1,509,658 | 1,609,928 | 3,119,586 |
| Family Support | 261,698 | 255,040 | 561,738 |
| State Operated Institutions | 425,412 | 458,904 | 884,316 |
| Legisl., Judicial, Const. Officers | 249,463 | 278,205 | 527,668 |
| State Agencies' Operations & Grants | 870,839 | 964,609 | 1,835,448 |
| Debt Service | 245,637 | 299,565 | 545,202 |
| Capital Projects | 300,031 | 600,659 | 900,690 |
| Estimated Cancellations | 0 | (15,643) | (15,643) |
| Subtotal-Major Spending Categories | 10,055,706 | 11,310,457 | 21,366,163 |
| Dedicated Expenditures | 156,540 | 126,782 | 283,322 |
| Total Expenditures & Transfers | 10,212,246 | 11,437,239 | 21,649,485 |
| Balance Before Reserves | 2,527,216 | 2,586,678 | 2,586,678 |
| Cash Flow Account | 350,000 | 350,000 | 350,000 |
| Budget Reserve | 513,200 | 622,000 | 622,000 |
| Property Tax Reserve Account | 550,802 | 330,181 | 330,181 |
| Tax Reform & Reduction Account | 0 | 200,000 | 200,000 |
| Dedicated Reserves | 126,801 | 131,760 | 131,760 |
| Appropriations Carried Forward | 306,405 | N/A | N/A |
| Budgetary Balance | 680,008 | 952,737 | 952,737 |

F.Y. 1998-99 Comparison
End-of-Session vs November 1998 Forecast
(\$ in Thousands)

| | 4-98 Enacted F.Y. 1998-99 | 11-98 Fcst F.Y. 1998-99 | Difference |
|---|--------------------------------------|------------------------------------|-------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,994,720 | 1,994,720 | 0 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 9,223,387 | 9,742,669 | 519,282 |
| Sales Tax | 6,593,941 | 6,665,339 | 71,398 |
| Corporate Income Tax | 1,553,189 | 1,459,461 | (93,728) |
| Motor Vehicle Excise | 816,000 | 879,976 | 63,976 |
| Tobacco Settlements | 0 | 461,097 | 461,097 |
| Other Non-Dedicated Revenue | 1,936,509 | 2,107,276 | 170,767 |
| Subtotal Net Non-Ded. Rev. | 20,123,026 | 21,315,818 | 1,192,792 |
| Dedicated Revenue | 324,055 | 345,052 | 20,997 |
| Transfers In | 509,817 | 544,023 | 34,206 |
| Prior Year Adjustments | 20,200 | 36,550 | 16,350 |
| Subtotal-Current Resources | 20,977,098 | 22,241,443 | 1,264,345 |
| Total Resources Available | 22,971,818 | 24,236,163 | 1,264,345 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 6,950,917 | 6,912,229 | (38,688) |
| Property Tax Recognition | 108,800 | 108,900 | 100 |
| Post-Secondary Education | 2,450,969 | 2,444,134 | (6,835) |
| Property Tax Aids & Credits | 2,600,217 | 2,575,844 | (24,373) |
| Other Major Local Assistance | 1,021,704 | 1,011,051 | (10,653) |
| Health Care | 3,292,659 | 3,119,586 | (173,073) |
| Family Support | 536,798 | 516,738 | (20,060) |
| State Operated Institutions | 891,394 | 884,316 | (7,078) |
| Legisl., Judicial, Const. Officers | 513,692 | 527,668 | 13,976 |
| State Agencies' Operations & Grants | 1,832,009 | 1,835,448 | 3,439 |
| Debt Service | 571,594 | 545,202 | (26,392) |
| Capital Projects | 500,690 | 900,690 | 400,000 |
| Estimated Cancellations | (20,643) | (15,643) | 5,000 |
| Subtotal-Major Spending Categories | 21,250,800 | 21,366,163 | 115,363 |
| Dedicated Expenditures | 294,486 | 283,322 | (11,164) |
| Total Expenditures & Transfers | 21,545,286 | 21,649,485 | 104,199 |
| Balance Before Reserves | 1,426,532 | 2,586,678 | 1,160,146 |
| Cash Flow Account | 350,000 | 350,000 | 0 |
| Budget Reserve | 613,200 | 622,000 | 8,800 |
| Property Tax Reserve Account | 330,942 | 330,181 | (761) |
| Tax Reform & Reduction Account | 0 | 200,000 | 200,000 |
| Dedicated Reserves | 97,248 | 131,760 | 34,512 |
| Budgetary Balance | 35,142 | 952,737 | 917,595 |

Biennial Comparison
F.Y. 1998-99 vs F.Y. 2000-01
(\$ in Thousands)

| | 11-98 Fcst F.Y.1998-99 | 11-98 Plng Est F.Y. 2000-01 | \$ Difference | % Change |
|--|---------------------------|--------------------------------|------------------|--------------|
| Actual & Estimated Resources | | | | |
| Balance Forward From Prior Year | 1,994,720 | 2,586,678 | 591,958 | 29.7% |
| Current Resources: | | | | |
| Net Non-Dedicated Revenue | | | | |
| Individual Income Tax | 9,742,669 | 11,699,400 | 1,956,731 | 20.1% |
| Sales Tax | 6,665,339 | 7,321,539 | 656,200 | 9.8% |
| Corporate Income Tax | 1,459,461 | 1,351,900 | (107,561) | -7.4% |
| Motor Vehicle Excise | 879,976 | 883,000 | 3,024 | 0.3% |
| Tobacco Settlements | 461,097 | 727,250 | 266,153 | 57.7% |
| Other Non-Dedicated Revenue | 2,107,276 | 1,991,483 | (115,793) | -5.5% |
| Subtotal Net Non-Dedic Revenue | 21,315,818 | 23,974,572 | 2,658,754 | 12.5% |
| Dedicated Revenue | 345,052 | 237,320 | (107,732) | -31.2% |
| Transfers In | 544,023 | 405,901 | (138,122) | -25.4% |
| Prior Year Adjustments | 36,550 | 20,200 | (16,350) | -44.7% |
| Subtotal-Current Resources | 22,241,443 | 24,637,993 | 2,396,550 | 10.8% |
| Total Resources Available | 24,236,163 | 27,224,671 | 2,988,508 | 12.3% |
| Actual & Estimated Spending by Function | | | | |
| Education / Children & Families | 6,912,229 | 7,608,952 | 696,723 | 10.1% |
| Property Tax Recognition | 108,900 | 0 | (108,900) | -100.0% |
| Post-Secondary Education | 2,444,134 | 2,466,476 | 22,342 | 0.9% |
| Property Tax Aids & Credits | 2,575,844 | 3,172,854 | 597,010 | 23.2% |
| Other Major Local Assistance | 1,011,051 | 1,133,544 | 122,493 | 12.1% |
| Health Care | 3,119,586 | 3,776,322 | 656,736 | 21.1% |
| Family Support | 516,738 | 518,697 | 1,959 | 0.4% |
| State Operated Institutions | 884,316 | 967,238 | 82,922 | 9.4% |
| Legisl., Judicial, Const. Officers | 527,668 | 532,328 | 4,660 | 0.9% |
| State Agencies' Operations & Grants | 1,835,448 | 1,682,056 | (153,392) | -8.4% |
| Debt Service | 545,202 | 535,501 | (9,701) | -1.8% |
| Capital Projects | 900,690 | 0 | (900,690) | -100.0% |
| Estimated Cancellations | (15,643) | (20,000) | (4,357) | 27.9% |
| Subtotal-Major Spending Categories | 21,366,163 | 22,373,969 | 1,007,806 | 4.7% |
| Dedicated Expenditures | 283,322 | 221,551 | (61,771) | -21.8% |
| Total Expenditures & Transfers | 21,649,485 | 22,595,520 | 946,035 | 4.4% |
| Balance Before Reserves | 2,586,678 | 4,629,151 | 2,042,473 | |
| Cash Flow Account | 350,000 | 350,000 | 0 | |
| Budget Reserve | 622,000 | 622,000 | 0 | |
| Property Tax Reserve Account | 330,181 | 0 | (330,181) | |
| Tax Reform & Reduction Account | 200,000 | 200,000 | 0 | |
| Dedicated Reserves | 131,760 | 133,105 | 1,345 | |
| Budgetary Balance | 952,737 | 3,324,046 | 2,371,309 | |

F.Y. 2000-01 General Fund Planning Estimates
Comparison: End-of-Session vs November 1998 Forecast
(\$ in Thousands)

| | 4-98 Plng Est F.Y. 2000-01 | 11-98 Plng Est F.Y. 2000-01 | Difference |
|---|---------------------------------------|--|-------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,426,532 | 2,586,678 | 1,160,146 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 11,013,390 | 11,699,400 | 686,010 |
| Sales Tax | 7,172,446 | 7,321,539 | 149,093 |
| Corporate Income Tax | 1,595,843 | 1,351,900 | (243,943) |
| Motor Vehicle Excise | 824,700 | 883,000 | 58,300 |
| Tobacco Settlements | 0 | 727,250 | 727,250 |
| Other Non-Dedicated Revenue | 1,839,895 | 1,991,483 | 151,588 |
| Subtotal Net Non-Ded. Rev. | 22,446,274 | 23,974,572 | 1,528,298 |
| Dedicated Revenue | 295,455 | 237,320 | (58,135) |
| Transfers In | 496,266 | 405,901 | (90,365) |
| Prior Year Adjustments | 20,200 | 20,200 | 0 |
| Subtotal-Current Resources | 23,258,195 | 24,637,993 | 1,379,798 |
| Total Resources Available | 24,684,727 | 27,224,671 | 2,539,944 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 7,688,408 | 7,608,952 | (79,456) |
| Post-Secondary Education | 2,502,436 | 2,466,476 | (35,960) |
| Property Tax Aids & Credits | 3,236,524 | 3,172,854 | (63,669) |
| Other Major Local Assistance | 1,097,791 | 1,133,544 | 35,752 |
| Health Care | 4,031,327 | 3,776,322 | (255,004) |
| Family Support | 564,866 | 518,697 | (46,169) |
| State Operated Institutions | 954,685 | 967,238 | 12,553 |
| Legisl., Judicial, Const. Officers | 524,297 | 532,328 | 8,032 |
| State Agencies' Operations & Grants | 1,690,335 | 1,682,056 | (8,279) |
| Debt Service | 584,210 | 535,501 | (48,709) |
| Estimated Cancellations | (20,000) | (20,000) | 0 |
| Subtotal-Major Spending Categories | 22,854,879 | 22,373,969 | (480,910) |
| Dedicated Expenditures | 279,686 | 221,551 | (58,135) |
| Total Expenditures & Transfers | 23,134,565 | 22,595,520 | (539,045) |
| Balance Before Reserves | 1,550,162 | 4,629,151 | 3,078,989 |
| Cash Flow Account | 350,000 | 350,000 | 0 |
| Budget Reserve | 613,200 | 622,000 | 8,800 |
| Tax Reform & Reduction Account | 0 | 200,000 | 200,000 |
| Dedicated Reserves | 67,460 | 133,105 | 65,645 |
| Budgetary Balance | 519,502 | 3,324,046 | 2,804,544 |

F.Y. 1998-2003 Planning Horizon
November 1998 General Fund Forecast
(\$ in Thousands)

| | 11-98 Fcst F.Y. 1998-99 | 11-98 Plng Est F.Y. 2000-01 | 11-98 Plng Est F.Y. 2002-03 |
|---|------------------------------------|--|--|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,994,720 | 2,586,678 | 4,629,151 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 9,742,669 | 11,699,400 | 12,881,500 |
| Sales Tax | 6,665,339 | 7,321,539 | 7,931,600 |
| Corporate Income Tax | 1,459,461 | 1,351,900 | 1,465,700 |
| Motor Vehicle Excise | 879,976 | 883,000 | 931,400 |
| Tobacco Settlements | 461,097 | 727,250 | 695,500 |
| Other Non-Dedicated Revenue | 2,107,276 | 1,991,483 | 1,977,368 |
| Subtotal Net Non-Ded. Rev. | 21,315,818 | 23,974,572 | 25,883,068 |
| Dedicated Revenue | 345,052 | 237,320 | 221,552 |
| Transfers In | 544,023 | 405,901 | 492,489 |
| Prior Year Adjustments | 36,550 | 20,200 | 20,200 |
| Subtotal-Current Resources | 22,241,443 | 24,637,993 | 26,617,309 |
| Total Resources Available | 24,236,163 | 27,224,671 | 31,246,460 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 6,912,229 | 7,608,952 | 7,935,717 |
| Property Tax Recognition | 108,900 | 0 | 0 |
| Post-Secondary Education | 2,444,134 | 2,466,476 | 2,613,030 |
| Property Tax Aids & Credits | 2,575,844 | 3,172,854 | 3,496,043 |
| Other Major Local Assistance | 1,011,051 | 1,133,544 | 1,223,816 |
| Health Care | 3,119,586 | 3,776,322 | 4,566,859 |
| Family Support | 516,738 | 518,697 | 561,687 |
| State Operated Institutions | 884,316 | 967,238 | 1,034,201 |
| Legisl., Judicial, Const. Officers | 527,668 | 532,328 | 555,395 |
| State Agencies' Operations & Grants | 1,835,448 | 1,682,056 | 1,759,069 |
| Debt Service | 545,202 | 535,501 | 561,012 |
| Capital Projects | 900,690 | 0 | 0 |
| Estimated Cancellations | (15,643) | (20,000) | (20,000) |
| Subtotal-Major Spending Categories | 21,366,163 | 22,373,969 | 24,286,829 |
| Dedicated Expenditures | 282,322 | 221,551 | 221,552 |
| Total Expenditures & Transfers | 21,649,485 | 22,595,520 | 24,508,381 |
| Balance Before Reserves | 2,586,678 | 4,629,151 | 6,738,079 |
| Cash Flow Account | 350,000 | 350,000 | 350,000 |
| Budget Reserve | 622,000 | 622,000 | 622,000 |
| Property Tax Reserve Account | 330,181 | 0 | 0 |
| Tax Reform & Reduction Account | 200,000 | 200,000 | 200,000 |
| Dedicated Reserves | 131,760 | 133,105 | 133,105 |
| Budgetary Balance | 952,737 | 3,324,046 | 5,432,974 |

2000-01 General Fund Planning Estimates
Base, Inflation, Total
(\$ in Thousands)

| | 11-98 Base F.Y. 2000-01 | Inflation F.Y. 2000-01 | 11-98 Plng Est F.Y. 2000-01 |
|---|------------------------------------|-----------------------------------|--|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 2,586,678 | 0 | 2,586,678 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 11,699,400 | 0 | 11,699,400 |
| Sales Tax | 7,321,539 | 0 | 7,321,539 |
| Corporate Income Tax | 1,351,900 | 0 | 1,351,900 |
| Motor Vehicle Excise | 883,000 | 0 | 883,000 |
| Tobacco Settlements | 727,250 | 0 | 727,250 |
| Other Non-Dedicated Revenue | 1,991,483 | 0 | 1,991,483 |
| Subtotal Net Non-Ded. Rev. | 23,974,572 | 0 | 23,974,572 |
| Dedicated Revenue | 237,320 | 0 | 237,320 |
| Transfers In | 405,901 | 0 | 405,901 |
| Prior Year Adjustments | 20,200 | 0 | 20,200 |
| Subtotal-Current Resources | 24,637,993 | 0 | 24,637,993 |
| Total Resources Available | 27,224,671 | 0 | 27,224,671 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 7,331,768 | 277,184 | 7,608,952 |
| Post-Secondary Education | 2,376,362 | 90,114 | 2,466,476 |
| Property Tax Aids & Credits | 3,055,387 | 117,467 | 3,172,854 |
| Other Major Local Assistance | 1,092,217 | 41,327 | 1,133,544 |
| Health Care | 3,637,802 | 138,520 | 3,776,322 |
| Family Support | 499,752 | 18,945 | 518,697 |
| State Operated Institutions | 931,873 | 35,365 | 967,238 |
| Legisl., Judicial, Const. Officers | 512,975 | 19,353 | 532,328 |
| State Agencies' Operations & Grants | 1,621,822 | 60,234 | 1,682,056 |
| Debt Service | 535,501 | 0 | 535,501 |
| Estimated Cancellations | (20,000) | 0 | (20,000) |
| Subtotal-Major Spending Categories | 21,575,459 | 798,510 | 22,373,969 |
| Dedicated Expenditures | 221,551 | 0 | 221,551 |
| Total Expenditures & Transfers | 21,797,010 | 798,510 | 22,595,520 |
| Balance Before Reserves | 5,427,661 | (798,510) | 4,629,151 |
| Cash Flow Account | 350,000 | 0 | 350,000 |
| Budget Reserve | 622,000 | 0 | 622,000 |
| Tax Reform & Reduction Account | 200,000 | 0 | 200,000 |
| Dedicated Reserves | 133,105 | 0 | 133,105 |
| Budgetary Balance | 4,122,556 | (798,510) | 3,324,046 |

F.Y. 1998-99 Comparison Before Allocations *
End-of-Session vs November 1998 Forecast
(\$ in Thousands)

| | 4-98 Enacted F.Y. 1998-99 | 11-98 Fcst F.Y. 1998-99 | Difference |
|---|------------------------------|----------------------------|------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,994,720 | 1,994,720 | 0 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 9,223,387 | 9,742,669 | 519,282 |
| Sales Tax | 6,593,941 | 6,665,339 | 71,398 |
| Corporate Income Tax | 1,553,189 | 1,459,461 | (93,728) |
| Motor Vehicle Excise | 816,000 | 879,976 | 63,976 |
| Tobacco Settlements | 0 | 461,097 | 461,097 |
| Other Non-Dedicated Revenue | 1,936,509 | 2,107,276 | 170,767 |
| Subtotal Net Non-Ded. Rev. | 20,123,026 | 21,315,818 | 1,192,792 |
| Dedicated Revenue | 324,055 | 345,052 | 20,997 |
| Transfers In | 509,817 | 544,023 | 34,206 |
| Prior Year Adjustments | 20,200 | 36,550 | 16,350 |
| Subtotal-Current Resources | 20,977,098 | 22,241,443 | 1,264,345 |
| Total Resources Available | 22,971,818 | 24,236,163 | 1,264,345 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 6,950,917 | 6,912,229 | (38,688) |
| Property Tax Recognition | 108,800 | 108,900 | 100 |
| Post-Secondary Education | 2,450,969 | 2,444,134 | (6,835) |
| Property Tax Aids & Credits | 2,600,217 | 2,575,844 | (24,373) |
| Other Major Local Assistance | 1,021,704 | 1,011,051 | (10,653) |
| Health Care | 3,292,659 | 3,119,586 | (173,073) |
| Family Support | 536,798 | 516,738 | (20,060) |
| State Operated Institutions | 891,394 | 884,316 | (7,078) |
| Legisl., Judicial, Const. Officers | 513,692 | 527,668 | 13,976 |
| State Agencies' Operations & Grants | 1,832,009 | 1,835,448 | 3,439 |
| Debt Service | 571,594 | 545,202 | (26,392) |
| Capital Projects | 500,690 | 500,690 | 0 |
| Estimated Cancellations | (20,643) | (15,643) | 5,000 |
| Subtotal-Major Spending Categories | 21,250,800 | 20,966,163 | (284,637) |
| Dedicated Expenditures | 294,486 | 283,322 | (11,164) |
| Total Expenditures & Transfers | 21,545,286 | 21,249,485 | (295,801) |
| Balance Before Reserves | 1,426,532 | 2,986,678 | 1,560,146 |
| Cash Flow Account | 350,000 | 350,000 | 0 |
| Budget Reserve | 613,200 | 613,200 | 0 |
| Property Tax Reserve Account | 330,942 | 330,181 | (761) |
| Tax Reform & Reduction Account | 0 | 0 | 0 |
| Dedicated Reserves | 97,248 | 131,760 | 34,512 |
| Budgetary Balance | 35,142 | 1,561,537 | 1,526,395 |

* Forecast reflects estimates before current law allocations of \$400 million to capital projects, \$200 million to the tax reform & reduction account, and \$8.8 million to the budget reserve.

F.Y. 2000-01 General Fund Planning Estimates Before Allocations *
Comparison: End-of-Session vs November 1998 Forecast
(\$ in Thousands)

| | 4-98 Plng Est F.Y. 2000-01 | 11-98 Plng Est F.Y. 2000-01 | Difference |
|---|---------------------------------------|--|-------------------|
| Actual & Estimated Resources: | | | |
| Balance Forward From Prior Year | 1,426,532 | 2,986,678 | 1,560,146 |
| Current Resources: | | | |
| Net Non-Dedicated Revenue | | | |
| Individual Income Tax | 11,013,390 | 11,699,400 | 686,010 |
| Sales Tax | 7,172,446 | 7,321,539 | 149,093 |
| Corporate Income Tax | 1,595,843 | 1,351,900 | (243,943) |
| Motor Vehicle Excise | 824,700 | 883,000 | 58,300 |
| Tobacco Settlements | 0 | 727,250 | 727,250 |
| Other Non-Dedicated Revenue | 1,839,895 | 1,991,483 | 151,588 |
| Subtotal Net Non-Ded. Rev. | 22,446,274 | 23,974,572 | 1,528,298 |
| Dedicated Revenue | 295,455 | 237,320 | (58,135) |
| Transfers In | 496,266 | 405,901 | (90,365) |
| Prior Year Adjustments | 20,200 | 20,200 | 0 |
| Subtotal-Current Resources | 23,258,195 | 24,637,993 | 1,379,798 |
| Total Resources Available | 24,684,727 | 27,624,671 | 2,939,944 |
| Actual & Estimated Spending by Function: | | | |
| Education /Children & Families | 7,688,408 | 7,608,952 | (79,456) |
| Post-Secondary Education | 2,502,436 | 2,466,476 | (35,960) |
| Property Tax Aids & Credits | 3,236,524 | 3,172,854 | (63,669) |
| Other Major Local Assistance | 1,097,791 | 1,133,544 | 35,752 |
| Health Care | 4,031,327 | 3,776,322 | (255,004) |
| Family Support | 564,866 | 518,697 | (46,169) |
| State Operated Institutions | 954,685 | 967,238 | 12,553 |
| Legisl., Judicial, Const. Officers | 524,297 | 532,328 | 8,032 |
| State Agencies' Operations & Grants | 1,690,335 | 1,682,056 | (8,279) |
| Debt Service | 584,210 | 587,915 | 3,705 |
| Capital Projects | 0 | 0 | 0 |
| Estimated Cancellations | (20,000) | (20,000) | 0 |
| Subtotal-Major Spending Categories | 22,854,879 | 22,426,383 | (428,496) |
| Dedicated Expenditures | 279,686 | 221,551 | (58,135) |
| Total Expenditures & Transfers | 23,134,565 | 22,647,934 | (486,631) |
| Balance Before Reserves | 1,550,162 | 4,976,737 | 3,426,575 |
| Cash Flow Account | 350,000 | 350,000 | 0 |
| Budget Reserve | 613,200 | 613,200 | 0 |
| Tax Reform & Reduction Account | 0 | 0 | 0 |
| Dedicated Reserves | 67,460 | 133,105 | 65,645 |
| Budgetary Balance | 519,502 | 3,880,432 | 3,360,930 |

* Forecast reflects estimates before current law allocations of \$400 million to capital projects, \$200 million to the tax reform & reduction account, and \$8.8 million to the budget reserve.